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Building a European Champion – The Case of the European Aeronautic Defence and Space Company.

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Abstract

In the context of the plans for a single European aerospace and defense company, why did France and Germany decide to build the European transnational champion EADS, whereas the United Kingdom opted for strengthening its national champion British Aerospace? Assuming that a transnational champion strategy implies relinquishing national control and political influence over a strategic industrial sector, this thesis sheds light on the conditions under which governments are ready to accept this. By drawing on the Varieties of Capitalism approach (Hall & Soskice 2001), I argue that it is not governments' preferences that can explain the variation in consolidation strategies but national institutional settings. Different types of capitalism feature different coordination mechanisms between state and private actors, and, since managers of the predominantly private firms partake in this decision, their coordination with the government determines the outcome. By conducting a comparative process-tracing analysis, I demonstrate that in the United Kingdom, arm's length-relationships between the government and British Aerospace and the non-intervention of Prime Minister Blair resulted in a national champion strategy. On the contrary, in Germany and France there was strategic interaction between public and private actors that enabled the alignment of their interests. Thus, concerns about surrendering national control were mitigated by assurances through cooperative behavior, network structures, and commitment, and transnational consolidation was possible. By proposing an institutionalist argument, I go beyond the existing literature on the consolidation of the European aerospace and defense sector, which mainly focuses on realist and functionalist drivers of consolidation but cannot account for the variation in strategies.

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List of abbreviations

BAe..British Aerospace/BAe Systems

CASA ....Construcciones Aeronáuticas S.A.

CME ....Coordinated market economy

DASA ....DaimlerChrysler Aerospace Aktiengesellschaft

DGA ....Direction générale de l'Armement

DTIB..Defence Technological and Industrial Base

EADS ....European Aeronautic Defence and Space company

ENA..École nationale d'administration

GEC ....General Electric Company

IR...International Relations

LME ....Liberal market economy

MSSD ....Most similar systems design

SME..State-influenced market economy

TNCs ....Transnational Corporations

UK ....United Kingdom

VoC ....Varieties of Capitalism

1 Introduction

“Europe gets a defence giant” said the headline in The Economist on 14 October 1999, the day DASA and Aérospatiale-Matra agreed to form the European Aeronautic Defence and Space company (EADS), Europe’s largest aerospace group (The Economist 1999). EADS was formed as a transnational Franco-German company with a small Spanish participation.[1] DaimlerChrysler chairman Jürgen Schrempp called the merger a "ground-breaking contribution to the integration of the aerospace industry in Europe” (Morgan 1999) and Jean-Luc Lagardère referred to it as a “new chapter in the history of European cooperation” (Interavia Business & Technology 1999). Initially, the European company was supposed to be comprised of the four partners of the Airbus GIE consortium, which would also include British Aerospace. However, the British, in a surprising move, withdrew from the negotiations and opted for an all-British national merger instead (Heller 1999). This thesis, by focusing on the government perspective, attempts to make sense of this variation in government strategies for consolidating the European aerospace and defense sector.

The demand for consolidation arose due to the globalization of the sector (James 2002), increasing international competition and decreasing national defense budgets (Schmitt 2000: 5). Governments needed to find an adequate response to these pressures by restructuring their industries. In doing so, they had various options at hand: They could continue with their strategy of loose European cooperation in the aerospace and defense sector through strategic alliances, joint ventures and consortia (Schmitt 2000: 17–18). The other option was to consolidate the European sector by completely integrating firms.[2] There are various benefits to the consolidation of the aerospace and defense sector such as cost savings and reduction of overcapacities across Europe.[3] However, the transnational consolidation of firms from different

[1] CASA officially joined EADS in December 1999 with a small participation of 6,25 percent. Already in June 1999, CASA had agreed to merge with DASA but the EADS mergers plans delayed the deal (Die Welt 1999).

[2] Consolidation refers to the horizontal or vertical mergers and acquisitions of firms. A horizontal merger is a merger between firms that operate in the same industry and thus are competitors. A vertical merger takes place when firms from different parts of the supply chain consolidate to make the production process more efficient or cost effective (Grant 2019).

[3] Among the advantages of consolidation are the reduction of duplication and overcapacity, which are being produced e.g. by joint ventures, since none of the parties in the latter arrangement is actually abandoning some of its technological capabilities (Schmitt 2000: 18). Other positive economic effects of industry consolidation are an increase in cost efficiency and firm performance due to shared R&D costs, knowledge sharing, technological diffusion etc. Moreover, the recurring problem of complying with the principle of *juste retour* does not apply when firms are completely integrated (Schmitt 2000: 18).

European countries also entails challenges. These challenges have their roots in the idiosyncratic structure of the aerospace and defense industry, being located at the intersection between a market-based logic and a logic of political governance.

For the state, the aerospace and defense industry is a strategic industry in both, military and economic terms (Hartley 2014: 4). On the one hand, it touches the realm of what are considered to be core state powers (Genschel & Jachtenfuchs 2016): the means to conduct acts of war, to defend one's territory and to guarantee security to one's citizens. On the other hand, it also comprises the production of civilian aircraft, which constitutes a strategic industrial asset for states. Following an economic logic, it is defined as a strategic industry due to its R&D-intensity and its ability to produce significant economies of scale and learning, capable of providing for a considerable number of highly skilled and highly paid jobs. In this way, the sector can positively contribute to growth and economic development of a country (Hartley 2014: 8). Following a security and military logic, it provides for military equipment and thus produces the strategic capabilities needed for warfare. Thus, it can be regarded to be a significant advantage for a state to be in possession of a national aerospace and defense industry, in order to assure the security of supply of important military and civilian products (Schmitt 2000: 60–61) and thereby create economic as well as strategic autonomy.

Hence, for reasons of national security as well as economic motives, the state has a vital interest in controlling this strategic industry. The debate about the battle over the governance of what Yergin & Stanislaw (2008) call the "commanding heights of the economy" also applies to the aerospace sector.[4] At the beginning of the 2000s, many of these once state-owned industries in telecommunications, energy, transport etc. had already been deregulated and privatized. The state had at least partly retreated and handed over control to the market (Goldstein 2000; Boubakri et al. 2009). However, when it comes to the aerospace and defense industry, the state still had a significant saying as either shareholder, regulator or monopsonist buyer of defense equipment (Kopač 2006: 283). Nevertheless, one could observe a trend reflecting a certain loss of control on part of the state and a development towards privatizing the industry and adopting the role of the regulator instead of the owner (Obinger et al. 2016).

If we understand the aerospace industry as belonging to the 'commanding heights' and strategic sectors of an economy, the formation of EADS is part of a general trend, a sequence of

[4] The original concept of the commanding heights, first introduced by Lenin, referred to utility industries like energy, telecommunications, mining and transport as well as so called heavy industry – sectors that were generating growth and employment and which thus in the communist ideology needed to be dominated by the state (Kling 2011).

transnational mergers and acquisitions in the areas of telecommunications (e.g. Vodafone/Mannesmann), logistics (e.g. Deutsche Post/DHL) and energy (e.g. RWE/Innogy). However, if we consider it to be a defense industry, it is a vanguard and a unique case of successful transnational consolidation after a variety of unsuccessful attempts in the sector (Guay & Callum 2002: 760). Indeed, EADS was the first case of a complete transnational merger in the aerospace and defense industry (Ferreri 2003: 18).

In times of a changing international setting due to globalization of the sector, governments face the challenge of balancing their national security interests and their economic interests. Transnational consolidation would be an answer to the demand for European restructuring and the creation of an internationally competitive industry. However, becoming part of a transnational champion also implies relinquishing national control to foreign entities. Yet, in Europe, national consolidation is limited in its potential for further growth (Schmitt 2000: 26), albeit allowing for retaining national control. Against the backdrop of this trade-off, this thesis addresses the following question: *Why do governments choose the transnational champion strategy versus the national champion strategy in European aerospace and defense consolidation?* By answering this question, this thesis also aims at exploring under which conditions governments accept to relinquish national control over strategic industries and in which cases they want to retain this control.

Drawing on the comparative capitalism literature (Hall & Soskice 2001; Schmidt 2003; Schmidt 2009), I argue that country-specific *national institutional settings* can explain the variation in governments' choices of consolidation strategies in the case of the formation of EADS. More precisely, the structure of the sector situated between 'the market' and 'the state' requires government representatives to coordinate with private industrial actors and the outcome of this depends on institutionalized national coordination mechanisms. Thereby I explicitly say that it is not the trade-off between national security and economic efficiency interests that explains the variation in the outcome. To preview the conclusion of my thesis, I demonstrate that *strategic interaction* as coordination mechanism present in France as well as in Germany enabled actors to align their interests, facilitating cooperative solutions and thus reducing uncertainty about the future. As a result, the French and German governments were able to decide for a transnational champion strategy including the surrendering of national control.

My contribution to the literature is manifold: By proposing an institutionalist argument, I go beyond the existing literature on the consolidation of the European aerospace and defense sector, which mainly focuses on realist and functionalist drivers of consolidation but cannot account for the variation in strategies. Instead, I draw on previous research on the strategic sectors of energy and telecommunications (Colli et al. 2014), assuming that the aerospace and defense sector follows a similar logic. Moreover, I attempt to extend the applicability of this institutionalist argument by testing for strategic interaction of actors on a transnational level. Another contribution is the conceptualization of governments' preferences for consolidation along a *security–efficiency trade-off* which they face in their decision-making.

From a methodological perspective, this thesis relies on process-tracing methods (Beach & Pedersen 2019) to assess which causal factors are responsible for the variation in the dependent variable. Process-tracing "permits the examination of 'diagnostic' evidence within the process under study […] looking for observable implications of hypothesized explanations and gauging their 'fit' to specified hypotheses" (Calcara 2017: 528). The analysis is based on primary literature like newspaper articles as well as on secondary academic and policy literature.

In this thesis I proceed as follows: In the second chapter, I describe the two different strategies for consolidation and their implications for government control, and thereby conceptualize my dependent variable. The third chapter is the theory chapter of my thesis. It starts by presenting the state of the art of International Relations literature on the case and specifies the point of departure for my analysis. The second section of this chapter elaborates on the preference-based argument and introduces the security–efficiency trade-off governments face in their decision-making. Subsequently, I present my institutionalist argument about the impact government-firm coordination has on the variation in consolidation strategies, from which I then deduce my hypotheses. The chapter is completed by the observable implications I developed from my argument. In chapter four, I present the methodological approach of a process-tracing analysis as well as my case selection and data basis.

Chapter five is my empirical analysis. In the first section, I ascertain the manifestations of the dependent variable. Here I show evidence of the variation in consolidation strategies and the relinquishing or retaining of government control in the data. The following section rules out the purely preference-based explanation by demonstrating the similarity in governments' preferences. Subsequently, I present the empirical evidence of my institutionalist argument in my three case studies on the United Kingdom (UK), Germany and France. In the last section of chapter five, I test whether the data indicates that there exists a transnational coordination mechanism. In the conclusion, I summarize my main empirical findings, flesh out how they contribute to the literature, discuss the limitations of my results e.g. in terms of generalization of my findings and make suggestions for possible future research.

2 The dependent variable: Government strategies for consolidation

This chapter describes the two strategies governments have at their disposal in the European aerospace and defense industry consolidation process. Furthermore, it elaborates on the implications the choice for each one of the strategies has regarding government control and influence on their national aerospace sectors.

As I already have mentioned, the state has a vital interest in having access to and control of industries that belong to the 'commanding heights'. Within these strategic sectors, governments act on the one hand as rule setters and on the other hand as goal-oriented strategists (Colli et al. 2014: 487). They play an important role when it comes to supporting national champions in their ambition to conquer foreign markets, or conversely, in the protection of these firms against foreign competition. Governments do this by adopting regulations and industrial policies. Due to their strategic importance, utilities and other politically sensitive industries like defense industries were in the past frequently owned by the state and today are subject to strict regulations implemented by public agencies or directly by the government (Colli et al. 2014: 488–489). Hence, this illustrates a historical development from direct forms of state governance of these sectors towards a more indirect form.

Direct governance, i.e. *direct control* of a company, is conducted through state ownership and state shareholding of firms. This puts governments in a position where they are directly part of the decision-making and formulation of corporate strategies. State ownership can take the form of a 100 percent-ownership, where the state is the sole decision-maker, as compared to majority shareholding, where the government can indeed push through its preferences but under the consideration of other shareholders' interests (Schmitt 2000: 28). Minority shareholding provides the state with even less capacity to control the company. Here, one can distinguish between a blocking minority – i.e. the shareholder is able to prevent other companies buying or controlling the firm (Cambridge Dictionary 2019) – and a minority shareholding without the possibility of blocking. A special form of a blocking minority is the *golden share*, which gives its state shareholder veto power over changes to a company's charter. It also holds special voting rights, providing its holder with the ability to block another shareholder from taking more than a ratio of ordinary shares (Dhir 2019). The golden share emerged during the privatization era in the 1980s and 1990s and became popular among governments that aimed at securing control rights for the future development of their national champions, for instance to prevent foreign ownership. In this vein, *direct control* is a rather strong form of state intervention in a in the meanwhile mostly privatized sector.

Indirect governance, i.e. *indirect government influence*, on the other hand, occurs when states abandon direct forms of governance through privatization. Consequently, private managers are in charge of the company and represent the point of contact for government officials. Yet, governments are still able to influence the development of a national company by fulfilling their role as regulator and adopting policies that support and sponsor, as well as control and constrain the actions of strategic firms. Thereby, they also have influence on the "alliance policy" of their national champions within the process of restructuring (Schmitt 2000: 28).

With regards to the aerospace and defense industry as one type of strategic industry which is especially close to what is defined as the so-called national interest, state ownership as *direct governance* instrument was typical for the sector before privatizations were initiated in the 1980s. At the end of the 1990s, complete state ownership had more or less disappeared in the sector. Some countries, like the UK and France, however, kept instruments of direct control, like minority shareholding or golden shares (Weiss 2020, forthcoming). As for *indirect influence* on the defense industry, governments adopt procurement policies and other policies that regulate the market for defense goods, such as competition policies. They also exert considerable influence through their role as customer of defense goods (Fligstein 2006: 959). Moreover, they have an important function as regulator of the industry. Arms export regulations for example are supposed to be in line with foreign policy objectives and can furthermore be employed themselves as tools of foreign policy (see Thrall & Dorminey 2018).

Similar to privatization, transnational consolidation creates a governance arrangement in which the state relinquishes control in favor of private actors. However, transnational consolidation furthermore involves a change in ownership including the incorporation of foreign entities, which obtain partial control over the transnational company. Thus, the issue of foreign ownership is a central aspect in transnational consolidation. In the context of choosing new alliances and engaging in mergers, governments "fear that all of their national defense capacity might end up in the hands of firms from other countries" (Fligstein 2006: 950).

Hence, the cases of privatization and transnational consolidation are to some extent similar but differ as regards the important question of the presence or absence of *national* control. Although a privatized defense firm is not under direct state control anymore, it is still under national political influence, since it is clear that regulation, export control and procurement decisions fall under the responsibility of the national government, respectively the national procurement agency. What is more, in a national company, if private shareholders decide to sell the firm or merge it with a foreign company, the government as policy-maker and regulator still has a veto in this process.[5] When firms are transnational, this attribution of responsibilities gets blurry. In general, regulation of powerful transnational corporations (TNCs) becomes increasingly complicated for national governments (Ietto-Gillies 2019: 6). This issue is especially critical for the aerospace and defense industry, but also for other strategic industries which have experienced privatization, deregulation and Europeanisation.

Like privatization, the choice of transnational consolidation represents an instance of a government's decision on indirect governance arrangements, comparable to the delegation of authority and competences to international or European organizations and agencies (see Hawkins et al. 2006; Bradley & Kelley 2008; Abbott et al. 2016). In these instances, governments accept to surrender control in favor of efficiency gains but do this under conditions of uncertainty over future developments. Hereby they risk experiencing decision-making that runs counter to their own interests (Hawkins et al. 2006: 4). This is particularly risky when it is a matter of core state powers and national strategic interests. As with the delegation of security and defense policy decisions to a supranational or international level, states are reluctant to relinquish control of defense-industrial assets to actors who do not hold the same nationality as they do.

In this thesis, I investigate governments' choices regarding their strategies in the restructuring of the European aerospace and defense sector. Under the impact of defense-industrial globalization, governments are being pressured to react to a changing market and regulatory environment. With regard to this strategic choice, I distinguish between two options, which governments have at their disposal: retaining national control over this strategic industry versus relinquishing national control in favor of efficiency gains. I argue that in the first case, governments opt for a *national champion strategy*, whereas in the second case, they choose a *transnational champion strategy*. The choice for relinquishing national control can firstly mean to accept surrendering *direct control* like ownership and state shareholding, or secondly, the voluntary abandonment of *indirect influence* mechanisms such as the competence to influence the industry through regulation and industrial policies. Both can entail significant consequences for governmental access to important strategic decisions of the firms. The following table illustrates the two types of consolidation strategy.

[5] In Germany for example, this is due to the Foreign Trade Act (Außenwirtschaftsgesetz), which states that foreign companies need to register their interest with the German government when they intend to attain more than 25% of a German defense company (Brzoska 2019).

	Type I Strategy	Type II Strategy
Government's choice of strategy	National champion *Retain national control*	Transnational champion *Relinquish national control*

Table 1: The dependent variable (own illustration)

3 The theoretical approach

This chapter develops a theoretical argument for explaining governments' choices of strategy for the consolidation of the aerospace and defense sector in the context of a changing international setting and external pressures from globalization.

To begin with, the state of the art in International Relations research on the consolidation of the European aerospace and defense industry is presented. Subsequently, governments' preferences are discussed as a possible explanation for the variation in choice of government strategies. After assessing the shortcomings of this approach, I introduce an institutionalist argument which draws on the Varieties of Capitalism approach. Thereby I apply a concept from Comparative Political Economy, which deems appropriate when investigating a globalizing economic sector that is located at the intersection between political and economic rationales. In the next part of this chapter, I deduce hypotheses for consolidation strategies of the different types of capitalism plus a hypothesis on transnational coordination. Finally, I formulate observable implications for my process-tracing analysis, first, for the dependent variable and second, for my institutionalist argument.

3.1 State of the art and point of departure

The state of the art in International Relations (IR) literature on the restructuring of the European aerospace and defense industry engages with explanations that can broadly be grouped into the two camps being realism and functionalism. Gartzke (2010: 3) finds that "realist and neo-mercantilist arguments prevailed over liberal-institutionalist / globalisation arguments among policymakers and business leaders" in the debate on the EADS and Boeing McDonell Douglas mergers. According to his line of reasoning, the EADS merger is a Franco-German counterbalancing attempt to assure the survival and autonomy of the European aerospace and defense industry in the face of growing competitive pressures from the US mega primes. Likewise, Jones (2006: 242) makes the argument that "in a unipolar international system, EU states led by Germany, France, and Britain have collaborated in the defense industry to increase their economic and defense power and decrease reliance on the United States".

In contrast, Neal & Taylor (2001: 345) frame the same developments in a functionalist logic in which the reduced defense spending and the fact that „Europe has perhaps too many firms" in the aerospace sector are the drivers for change in the European Defence Technological and Industrial Base (DTIB). Following this argument, the industrial landscape in combination with the shrinking market shares in Europe create functional economic pressures to consolidate and rationalize the sector. Thus, whereas Gartzke and Jones argue in a realist logic of relative power and survival in an international system of self-interested actors, Neal & Taylor (2001) emphasize the pressures created by a market-based logic that forces governments and corporate actors to reduce the number of national champions in the game. In the same vein, Guay & Callum (2002) introduce another economic explanation for the restructuring process: the permanently increasing costs of sophisticated weapons. They argue that the "only way to recover these costs is to lengthen production runs, which is best done by consolidating several small companies into a very few large ones" (Guay & Callum 2002: 764). In this way, the production of sophisticated goods like airplanes should be done in a more cost-efficient manner by companies that are big enough to compete internationally.

In sum, the existing IR literature on the subject predominantly offers explanations which identify the *drivers* of European aerospace and defense consolidation, such as growing international competition in the sector. This state of the art in IR research serves as my point of departure. Building on this literature, the following section engages with *governments' preferences* for reacting to the globalization of the sector. I conceptualize these preferences to be located along a *security–efficiency trade-off* that draws on the theoretical traditions of realism and functionalism.

3.2 Governments' preferences: managing the security–efficiency trade-off

The most obvious explanation for different consolidation strategies among European governments are their diverging preferences towards consolidation. These preferences are likely to include concerns for national security as well as for economic efficiency and supposedly determine a government's position towards retaining or relinquishing national control over a strategic industrial sector. In the following, I will elaborate on this in more detail.

First of all, goods produced by the aerospace and defense industry contribute to the security of supply of the armed forces and thus are crucial for the national security of a country (Schmitt 2000: 1). For precisely this reason, governments aim at retaining national control over those firms in general and over significant business decisions like change in ownership in particular. Even though today only a few countries are capable of sustaining defense industries of a magnitude that contributes to their national security (DeVore 2015: 570), the preservation of such capabilities is crucial to bigger European nations. Contrary to this perception of the aerospace and defense industry serving national security purposes, the survival of national strategic industries under the pressures of an internationalizing sector is important for the national economy of the exact same countries. In this context, governments are potentially forced to implement policies that sell off strategic control rights in favor of efficiency gains through cooperation and consolidation. Hence, governments find themselves in a situation where they must balance the interest of national security, on the one hand, and the interest of economic efficiency and international competitiveness of their industries on the other hand. I call this managing the *security–efficiency trade-off*. Governments face this trade-off in their decision-making within the realm of defense-industrial policy.

The defense (and aerospace) industry has historically been one of the most regulated economic sectors (Hoeffler 2012: 435). This is due to it being linked to national security interests. Since the creation of the modern nation-state, governments were in a dilemma: on the one hand, they realized that arms sales could bring economic benefits but on the other hand, these industries had to be controlled in order to preserve national security. The defense industries were basically a manifestation of national sovereignty (Hayward 1999: 8). This link to national sovereignty resulted in the dominance of the state's industrial interests and an exclusion of market forces from the sector (Hoeffler 2012: 435). On behalf of the state, procurement organizations define requirements, negotiate contracts with suppliers, oversee research and development and impose security restrictions on private firms. In some cases, the state even assumed full control of big national firms (Hayward 1999: 8).

However, the privatization trend of the 1980s and 1990s has also spilled over to the 'commanding heights' and within those even to the defense sector (Markusen 2003; Weiss 2020, forthcoming). Even though the direct role of the government in the defense and aerospace industries has decreased over the past decades, governments instead adopted more indirect means to "fulfil [their] goal of providing national support to the industry" (Landoni 2019: 175). After abandoning state ownership as one means of direct national control, some governments started to put in place contractual safeguards like special shares or minority shareholding in cases of industry privatization. Thereby, they managed to secure veto rights for the state to be able to prevent foreign ownership through takeovers in the future (Weiss 2020, forthcoming). The literature on economic patriotism for example engages with the question of the introduction of new protectionist measures as a result of fear of foreign ownership under the impact of globalization (Kim 2007; Hoeffler 2012; Clift & Woll 2013).

The debate about the preservation of national control over strategic industries for reasons of national security prerogatives follows a *realist logic* which emphasizes the relative power of nation states and describes the relationship among several states as being in a state of constant competition (Waltz 1990: 34–35). Cooperation between states, especially in the security sphere, is only possible to a very limited extent. The security dilemma – the way in which the attempt by one state to increase its security has the effect of decreasing the security of others (Jervis 1999: 49) – strongly affects the reasoning of governments and induces hesitation towards transnational cooperation in the security realm. Hence, national governments strive for preserving control of their aerospace and defense industries through, firstly, the prevention of foreign ownership and, secondly, the protection of national (military) capabilities.

With regard to technological and military capabilities, "[n]ational governments worry about how multinational defence companies could deal with purely national requirements and how strategic technological capabilities can be protected from foreign exploitation" (Crane 1999: 23). Moreover, the logic of cooperating in a transnational company implies that states will have to lose some of their defense-industrial capabilities (Crane 1999: 24), in order to exploit the advantages of specialization. However, European governments are in general very reluctant to give up on their national capabilities, since they provide them with some degree of strategic independence and autarky (Moravcsik 1991). Furthermore, national capabilities are closely connected to sustaining national production lines and thus to a significant amount of jobs for the national population. Yet, consolidation and especially cross-border consolidation might also involve rationalization and a related loss of jobs (Gartzke 2010: 37).

Contrary to the preference for national security, governments can also favor to succeed economically, which means to have a national industry that is able to compete and survive under the conditions of defense and aerospace-industrial globalization. Against the backdrop of the internationalization of the aerospace and defense markets during the 1990s (James 2002; Hayward 2010), European national firms had been lacking the critical mass to compete internationally – mainly against the recently created US giants (Schmitt 2000: 26). In light of the enormous consolidation and rationalization efforts of the US aerospace and defense industry, which "marked a spate of 'downsizings' and acquisitions, culminating in the mergers of Lockheed and Martin Marietta, Boeing and McDonnell Douglas, and Raytheon and Hughes" (Guay & Callum 2002: 762), European firms and policy-makers had been coming under pressure to react to these events. First and foremost, the 1997 Boeing takeover of McDonnell Douglas created a pressing problem for European competitors, since it was “an American firm of such scale, resources and product range as to dwarf European capabilities” (Thornton 2003: 3). Europeans were becoming worried that US defense firms would eventually dominate the European industry with the sheer size and market power of their companies (Kluth 2017: 161). Thus, the race for critical size achieved through mergers and acquisitions has become an essential preference for firms and their national governments alike.

Furthermore, since sustaining a national aerospace and defense industry has become more and more expensive and hardly affordable for a single state, efficiency gains through joint R&D and production are crucial to governments. Efficiency gains can be achieved through synergy effects and rationalization as part of consolidation endeavors (Schmitt 2000: 26–27). Similarly, the impact of decreasing defense budgets and the resulting drop in national demand for defense equipment pressures firms to increase their market shares. They can do this by conquering transnational defense markets, or alternatively forming cross-border collaborations in order to survive in the market, amid growing costs of staying in there (Hayward 1999: 12). Another factor that required action, e.g. by means of consolidation, was the overcapacity and duplication of capabilities that featured in both the European and US industries and needed to be dealt with by reducing the overall number of industrial programs in this area (Hayward 1999: 9–10). Following this line of reasoning, relinquishing national control in favor of economic efficiency and international competitiveness by means of mergers and acquisitions is a potential government decision in response to defense-industrial globalization. Since European countries do not have enough firms of relevant scale to achieve considerable effects by means of national consolidation, transnational integration of firms must be an option (Schmitt 2000: 26).

Prioritized logic	Substantive preferences
Security logic (realism)	**National security** • Prevent foreign ownership • Protect national capabilities • Protect national jobs and production sites
Economic logic (functionalism)	**Economic efficiency** • Afford national industry • Achieve critical size • Reduce overcapacities

Table 2: The security-efficiency trade-off (own illustration)

From this it follows that governments must make a decision on weighing national security against economic efficiency and position themselves somewhere on the scale between full national security (e.g. Israel) and complete focus on economic interests (e.g. small states without experiencing security threats). However, when translated into a strategy, there are various means to realize one's preferences. A prioritization of national security does not necessarily mean that the government is not ready at all for transnational consolidation. It can also mean that it opts for a transnational champion strategy with integrated safeguards, such as a golden share arrangement. Thereby, it is able to secure certain veto rights and influence on strategic decisions for the future (Dhir 2019). However, a national champion strategy still is the safest path to guarantee national control over the firm. This is the case since there is a risk that in a transnational company, a foreign state partner might not agree to any state shareholding incorporated in the joint company. In case a government prioritizes economic efficiency and international competitiveness, building a transnational champion is certainly an adequate strategy for the respective government, at least in Europe, where national consolidation opportunities are limited (Schmitt 2000: 26).

In sum, governments' preferences (functionalist and realist) can possibly drive their choice of strategy. Certainly, these considerations of national security and economic efficiency interests play a significant role in government decision-making in the defense-industrial realm. However, how would we explain observing *similar preferences* although *varying consolidation strategies* among European governments?[6]

[6] We can observe in the empirical data that although preferences play a role, the respective empirical realization of the security–efficiency trade-off is of varying relevance for governments' choices across

3.3 The institutionalist argument: The impact of government-firm coordination on consolidation strategies

The strand of IR literature which deals with drivers of aerospace and defense industry consolidation in Europe has left the question unanswered of why states choose different strategies to respond to events driving the demand for consolidation. To fill this gap in the literature on European aerospace and defense consolidation, instead of only identifying the drivers of restructuring, I attempt to account for the exact outcome of this consolidation process. I plan to do this in the specific case of the implementation of the vision of a single European aerospace company.

To this end, I suggest that a country's *national institutional setting* affects the outcome of *government-firm coordination* and thus eventually determines the *choice of government strategy* for consolidation. In other words, the institutional characteristics of a country's political economy – e.g. the historically-grown coordination mechanism between state and private actors – have an impact on which of the relevant actors is able to assert its preferences in the decision-making process.

Even though this thesis analyzes instances of consolidation from a political perspective, private industrial representatives are the other type of crucial actor within these processes. Since the firms involved are to a large extent private firms, their managers and private shareholders play a major role in the decision-making on mergers and acquisitions. Hence, their preferences need to be taken into account in the government strategy formation. For this reason, I presume that the government strategy is conditional on the preceding coordination between government and private industrial actors. This presumption reflects the idiosyncrasy of the aerospace and defense sector in being governed, on the one hand, by market forces and private sector actors and, on the other hand, by governmental control mechanisms.

For the purpose of developing an institutionalist argument to explain the variation in government strategies, I draw on the comparative capitalism literature and its Varieties of Capitalism approach (Soskice & Hall 2001; Schmidt 2003; Schmidt 2009). This will provide me with the necessary theoretical basis to present a plausible causal pathway of government strategy formation by taking into account the role of domestic politico-economic institutions. The Variety of Capitalism approach claims that a country's *form of capitalism* defines the degree of state intervention in the private sector and in this way affects the outcome of the

the three different countries selected in this thesis (in France and Germany, governments' preferences are relevant, in the UK, other factors determine the outcome).

interaction of state and corporate interests. In the literature, this approach has already been applied to strategic sectors like European utilities (Colli et al. 2014), telecommunications (Thatcher 2004) and to privatization in the German and British aerospace and defense industries (Weiss 2020, forthcoming). These contributions have yielded insights into the impact of government-business relations on the design of global players, privatization designs, and on market regulation in strategic industries.

Varieties of Capitalism (VoC) takes a firm-centered approach. Nevertheless, the relational concept of the firm makes its performance dependent on establishing constructive relationships with its different stakeholders, such as national governments with whom the firm has to coordinate effectively (Hall & Soskice 2001: 6). Thus, VoC follows a micro-foundational logic of coordination games among firms and governments (Schmidt 2009: 520). According to the approach, "national political economies can be compared by reference to the way in which firms resolve the coordination problems they face" (Hall & Soskice 2001: 8). Whereas Hall & Soskice (2001) differentiate between two types of political economies, liberal market economies (LME) and coordinated market economies (CME), Schmidt (2009) introduces a third type of capitalism that is labeled state-influenced market economies (SME), or state-enhanced capitalism when ideal-typically focused on France.

As a result of existing domestic institutional settings, political responses and dynamics vary across countries and engender diverse adaptation strategies (Thatcher 2004: 754). In LMEs, firms coordinate their activities predominantly via competitive market arrangements. These are characterized by an *arm's length exchange* between the actors, in a context of competition and formal contracting. In this type of capitalism, "the equilibrium outcomes of firm behavior are usually given by demand and supply conditions in competitive markets" (Hall & Soskice 2001: 8).

In contrast, in CMEs, firms coordinate their activities via non-market relationships. They rely on incomplete contracting, the exchange of information inside networks and *collaborative relationships*. They also feature intermediary institutions like business associations, which supply their members with "network reputational monitoring" which, in turn, provides them with information on other actors and their reputation (Hall & Soskice 2001: 23). In CMEs, the equilibria "are more often the result of strategic interaction among firms and other actors" (Hall & Soskice 2001: 8). Since CMEs rely on *strategic interaction* as mode of coordination, "the relevant institutions will be those that allow them to coordinate on equilibrium strategies that offer higher returns to all concerned" (Hall & Soskice 2009: 28). Their strategies are thus focused more on gains from cooperation and synergies and less on outcomes from competition. The institutions they rely on reduce uncertainty about the behavior of other actors and hence create opportunities for making "credible commitments" which, in turn, facilitates cooperation (Hall & Soskice 2009: 28–29). This is in line with the broad political science and IR literature, which agrees that institutions may make cooperation more likely by reducing uncertainty among the participants of the institution (Koremenos et al. 2001: 765–766).

The ideal-typical cases for an LME are the UK and the US. In these countries, the state is considered 'liberal' because it takes an *arm's length-approach* to business and labor, limiting its role to setting rules and settling conflicts and acting as a regulatory agent of market preservation. Firms tend to be rather autonomous, with comparatively little interference – whether supporting or hindering – by the state (Colli et al. 2014: 489–490). On the contrary, in CMEs like Germany, the state is *'enabling'* or *'facilitating'*, promoting non-market coordinating institutions like networks, negotiating compromises between capital and labor, and facilitating the activities of its economic actors. In SMEs, of which France is the ideal-typical example, the state is in an *'influencing'* or *'enhancing'* role and intervenes in the economy more frequently than in the other types of capitalism. What is more, it intervenes in a *hierarchical* way compared to a rather *cooperative* way, which is a characteristic of CMEs (Schmidt 2009: 520–522; Colli et al. 2014: 489–490).

Regarding the subject of firm ownership, LMEs rarely feature blockholding of shares and state ownership is nearly absent. Until the end of the 1990s, most of the larger British firms had been turned into public companies. Managers possess a considerable degree of autonomy, which they receive from the vastly fragmented ownership base. In CMEs and SMEs, blockholding is frequent and state shareholding is possible. Blockholders usually have significant influence on firm strategies and the selection of managers. However, the two types differ in "the role of the state as a possible dominant or relevant blockholder" (Colli et al. 2014: 492). In this vein, states that are more *dirigiste* (SMEs) and pursue national interests more forcefully, are more likely to intervene through direct ownership. In CMEs on the other hand, the state can function as blockholder, but typically shares influence with intermediary institutions like financial institutions (Colli et al. 2014: 491–492).

Although Schmidt (2003; 2009) refers to CMEs and SMEs as two types of capitalism and identifies various differences between them, Hall & Soskice (2001) consider them to be only one type of capitalism. Likewise, this thesis wants to focus on the many similarities between SMEs and CMEs, while also including the minor nuances that separate them – the more hierarchical versus more cooperative coordination, respectively the traditionally different degrees of state intervention.

In their work on European utilities, another national strategic sector, Colli et al. (2014: 492) argue that "[t]he more developmental the state's orientation (directive or corporatist), the more the government acts to create global players". This translates into the notion that *directive* (SME) and *corporatist* (CME) states tend to intervene more frequently in the creation of multinational (or transnational) companies. According to the authors, international growth of firms originates from the interaction of states and firms and depends on the emergence of *cooperative solutions*. More precisely, successful interaction between governments and firms enables *alignment of their interests* and thus the emergence of *coalitions* consisting of both types of actors, public and private. Within these coalitions, they "share goals and strategies" (Colli et al. 2014: 488). From this it follows that "government-firm coalitions that rely on the alignment of interests among actors provide superior pay-offs" (Colli et al. 2014: 489) for everyone.

For my theoretical argument, I combine the assumptions of the Varieties of Capitalism approach with the framework of Colli et al. (2014) and build a theoretical causal pathway of government strategy formation. I hypothesize that national politico-economic institutions vary between countries and they engender different mechanisms of coordination between state and private actors. These mechanisms of coordination differ in their ability to produce an alignment of interests and the building of coalitions among the actors. Countries that feature politico-economic institutions that allow for *strategic interaction* of the actors create opportunities for aligning interests and building coalitions with common goals and strategies. In these cases, the state takes a *facilitating* or *enhancing* role and actively intervenes in the strategy formation process. On the contrary, institutions which do not promote strategic interaction but create *arm's length-relationships* between the government and the firm constrain the chance for an alignment of interests and coalition-building. Likewise, the state, in this case, does not intervene in business decisions and only acts to preserve market forces.

I argue that strategic interaction allows for alignment of interests and coalition-building between state and private actors and thus paves the way for the government to opt for a transnational champion strategy. First, a transnational champion strategy requires the consent of both, government representatives and private owner/chairman of the company. Second, a transnational champion strategy implies the relinquishing of national control or influence. Therefore, governments will demand assurances from their private actors if accepting to surrender control over strategic industries under conditions of uncertainty over future behavior of other actors involved (see also Weiss 2020, forthcoming). These assurances are available through institutions featured in CMEs and SMEs, which provide for mutual trust and commitment between the actors via information-sharing, deliberation, monitoring, and sanctioning (Schwartz 2014: 572). Furthermore, the alignment of interests between government and private managers is especially important in cases of transnational restructuring, as this situation requires a common position of both parties in order to convey unity and thus strengthen the bargaining position vis-à-vis the foreign negotiating partner. In national consolidation, the alignment of interests is less important because foreign ownership is not part of the deal. Therefore, the government is assumed to have less concerns about national consolidation compared to transnational mergers and acquisitions.

In cases of transnational consolidation efforts, institutions that promote strategic interaction, e.g. through non-market relationships like networks, render negotiated agreements and balanced compromises more likely. The reason for this is that networks provide guarantees through regular exchange of information on the reputation of other actors and thus can improve predictability and create trust among the members (Schwartz 2014: 572). Therefore, networks, like other coordinative non-market institutions can serve as a forum for strategic interaction.

Hence, I suggest that *strategic interaction* between state and private actors is the causal mechanism that facilitates balanced agreements and compromises between these actors and eventually makes transnational consolidation possible. In other words, a lack of strategic interaction prevents actors from aligning their interests and the government is thus not ready to surrender national control in a transnational company because of uncertainty over the future.

In the words of Hall and Soskice: "If interaction of this sort is central to economic and political outcomes, the most important institutions distinguishing one political economy from another will be those conditioning such interaction" (Hall & Soskice 2001: 5). Since coordinated market economies as well as state-influenced market economies feature *strategic interaction* as their coordination mechanism between public and private actors and strategic interaction promotes the potential for aligning interests and forming coalitions, I expect transnational consolidation to occur in these types of capitalism. Moreover, I expect to observe patterns of more hierarchical coordination in SMEs and more cooperative and facilitating coordination in CMEs. From this I deduce the following hypotheses:

H1: *Coordination mechanisms of CMEs and SMEs feature strategic interaction of state and private actors and thus facilitate alignment of interests and coalition-building, which makes* *transnational consolidation and a government's willingness to relinquish national control/influence more likely.*

H2: *Coordination mechanisms in LMEs feature arm's length-relationships between state and private actors and thus do not facilitate alignment of interests and coalition-building, which makes it less likely to lead to transnational consolidation (and rather to national consolidation).*

From this it follows that the causal mechanism which is responsible for the transnational consolidation outcome is assumed to be *strategic interaction*. The presence or absence of this causal mechanism should influence the choice of strategy. However, it is important to note that this thesis presumes strategic interaction to be a necessary component of the process. What it does not claim is that it presents a sufficient causal explanation that includes all relevant explanatory factors.

The causal pathway of strategy formation thus comprises the following steps:

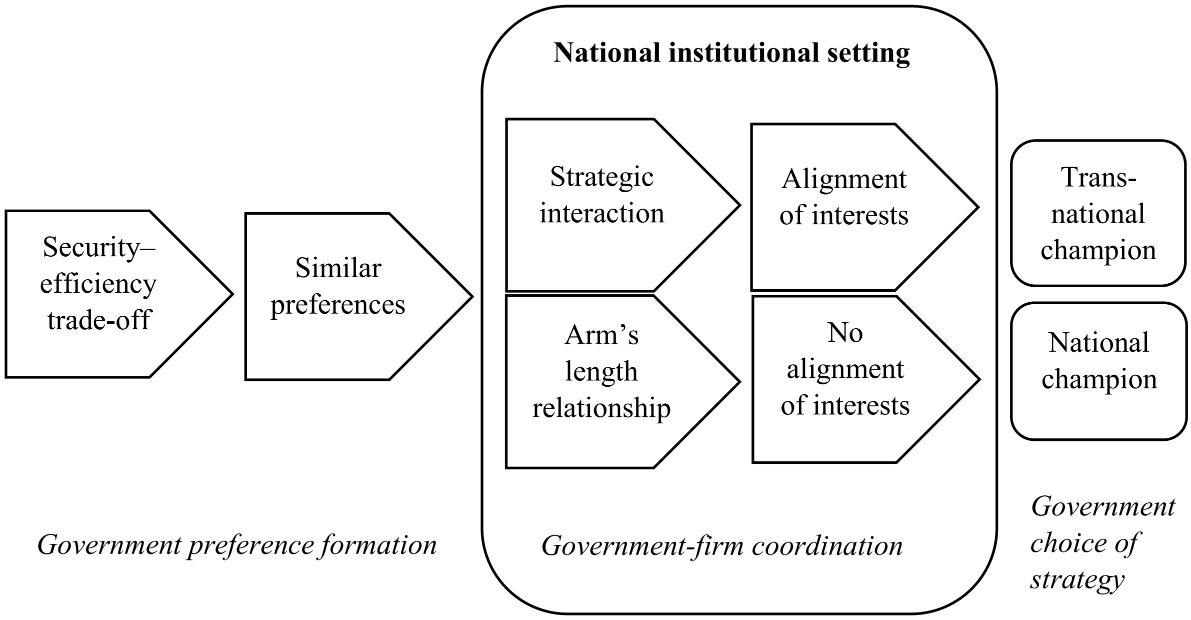

Figure 1: Causal pathway of strategy formation (own illustration)

My theoretical argument of specific national institutional settings which provide the opportunity for transnational consolidation was developed for the national level, since it attempts to explain the choice of a national government about a strategic decision on a national industry. Actors coordinate on a national level, which then enables consolidation on a transnational level. However, I moreover argue that it might be that the assumptions of Colli et al. (2014) are valid not only for the alignment of interests between government and firm on a national level, but also between different national governments and corporate actors from different countries who intend to be part of a transnational merger. More precisely, coalition-building based on aligned interests should also work on a transnational level. Hence, if actors from CMEs and SMEs partake in a negotiation, strategic interaction might be possible on the transnational level. This would require institutions like networks or business forums and groups to exist on a European level. Accordingly, I formulate a third hypothesis:

H3: Strategic interaction featured in CMEs and SMEs is also possible on a transnational level of coordination, i.e. between public and private actors of different states, and may facilitate transnational consolidation.

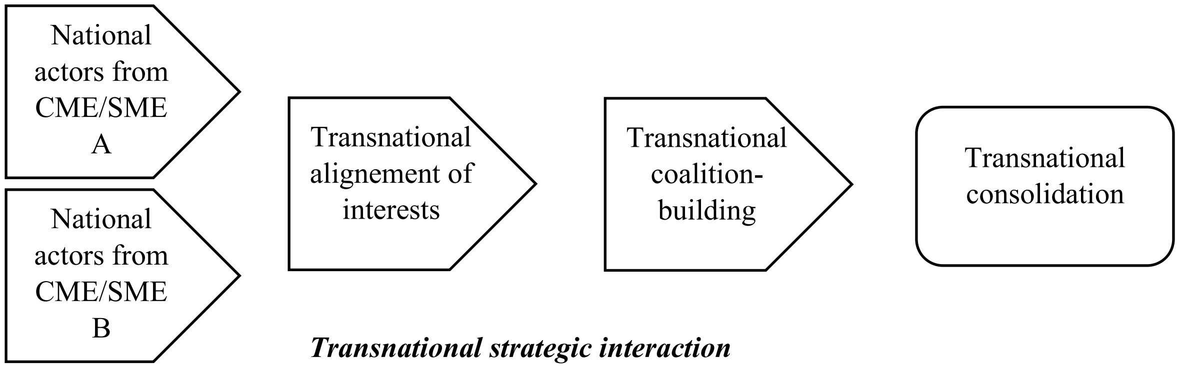

Figure 2: Transnational strategic interaction (own illustration)

3.4 Observable implications for the strategy formation process

In this section, I operationalize my three hypotheses and translate them into observable implications. Thus, I will be able to test whether my argument can account for the variation in choices of a consolidation strategy.

3.4.1 Observable implications for the choice of consolidation strategy

At the end of the strategy formation process (the causal pathway), governments will make a choice for one strategy, which will decide on the specific design of consolidation of their national aerospace and defense firms. They choose among two options: transnational champion building or national champion building.[7] The key aspects of this choice are the degree of control (direct), or influence (indirect), the governments were willing to give up upon. First, I look at the change in the ownership structure: the ratio between state shareholding, private block shareholding and shares floated on the stock exchange as well as the ratio between national and foreign ownership. Second, as an alternative to state shareholding, governments can secure themselves certain long-term rights to influence the firm. These can be special voting rights, a

[7] This is of course a reduction to only two choices, which is useful for the purpose of this thesis. In reality, there are more alternatives among which governments can choose when restructuring an industry.

veto for board resolutions on specific issues, national appointees to the board of directors or the right to appoint the top management (Bortolotti & Faccio 2009: 2918). Third, besides ownership and long-term influence on firm decision-making, governments are also expected to agree on the future of production sites, headquarters, jobs, as well as the important question of the access to and control of strategic assets such as nuclear capable aircraft. Finally, the choice of one strategy over the other will also have consequences for the role of the government as a regulator. For instance, the responsibility of the national procurement agencies is supposed to change when dealing with a transnational company.

When governments opt for the national champion strategy, they will attempt to retain as much national control over the firm as possible. This could mean maintaining some sort of state shareholding or special rights, insisting on access to the top management, emphasizing that national jobs are guaranteed etc. On the contrary, opting for the transnational champion strategy implies giving up on either direct control or indirect political influence. Here I expect to observe governments surrendering or reducing state shareholding, finding agreements with the foreign partner on how to share competences and responsibilities in the firm and even risking job cuts.

Strategies	**Observable implications**	
	Direct control	**Indirect influence**
National champion (retain national control)	Incorporate state shareholding, special veto; staff top management with nationals	Secure production sites, headquarters and jobs in your country; guarantee control over strategic assets
Transnational champion (relinquish national control)	Give up on or reduce state shareholding, share staffing of top management with foreign partner	Share production sites, risk cutting jobs, share headquarters, share control over strategic assets

Table 3: Observable implications for measuring the dependent variable (own illustration)

3.4.2 Observable implications for the institutionalist argument

In a first step, I identify the preferences for a consolidation strategy of each of the governments of my cases. I expect the preferences to be similar across European countries with major aerospace and defense industries participating in the global market and, thus, not constitutive for the choice of strategy, since they cannot explain the variation. As a consequence, I will put my theoretical argument to the test, which hypothesizes national institutional setting to have an impact on the outcome of the strategy formation process.

In order to demonstrate the explanatory power of my institutionalist argument, I need to observe a process of coordination between state and private actors, which accounts for the change from initially similar government preferences to eventually varying choices of strategy. This coordination mechanism is supposed to differ between the VoC-types of LMEs on the one hand, and CMEs and SMEs on the other hand.

In LMEs, the strategy formation is supposed to be a process of free market coordination, in which supply meets demand and the most attractive bidder is accepted. According to the *arm's length*-principle, the government should not intervene in a business decision on merger activities and let 'the market' and private actors make the choices. Thus, one should observe a rather passive behavior by the government and the prevailing of autonomous firms and their private managers' preferences in the process.

With regard to the coordination process in CMEs and SMEs, the actors are expected to engage in *strategic interaction*, i.e. actively engaging in finding a cooperative solution that allows for the alignment of interests of all parties and includes the possibility of compromises and negotiated agreements. In more detail, this coordination process should, however, be more hierarchical in SMEs (Schmidt 2009: 521), with outcomes that are *arranged* by the state by relying on an *elite network structure* comprised of public officials in the government and state administration and top managers in the leading firms (Hall & Soskice 2001: 35; Schmidt 2003: 542–543). These close personal and professional ties between the relevant actors in SMEs are expected to enable agreements that are based on the predictability of future behavior of those actors. Due to the 'dirigiste' and interventionist role of the state in SMEs (Schmidt 2003: 534), the government is able to use this network strategically to implement its preferences. Nonetheless, the network should also give the private actors considerable power to get concessions from the state (DeVore & Weiss 2014: 499). As a result, the network increases the likelihood of a negotiated solution that meets the interests of both, state and private actors. This significance of strategic coordination via network-like structures ought to be demonstrated in the process-tracing.

Coordination in CMEs is expected to be strategic interaction in form of institutionalized cooperation between state and industrial actors, supported through intermediary institutions like business associations (Streeck 2011: 21; Wueest 2013) and dense network relationships (Hall & Soskice 2001: 23; Schmidt 2003: 547). The state should intervene cooperatively in economic activities and act as a *facilitator* for its national firms by creating favorable conditions for them (Schmidt 2003: 548; Colli et al. 2014: 493).

SMEs and CMEs alike feature *strategic interaction* as non-market coordination mechanism. If actors from both types of capitalism interact on a transnational level, their coordination is expected to be strategic in case they can rely on institutions that promote such kinds of coordination. These can be for example transnational networks comprised of actors from different states. If this is the case, it should have a positive effect on the transnational negotiations and on the finding of cooperative solutions and compromises.

4 The research design

In this chapter, I elaborate on my research design and methodological approach with which I attempt to answer my research question. The investigation I will carry out in chapter 5 is a theory-driven empirical analysis for the purpose of explaining the variation in the outcome. In order to make sense of this outcome, I conduct a y-centered theory-building comparative process-tracing analysis (Beach & Pedersen 2019). In the following, I will first illustrate my choice of method and name its opportunities as well as limitations. Second, I discuss my selection of cases, which allows me to draw inferences based on the most similar systems design (MSSD) (Mill 2010 [1843]). Third, I inform on the data basis for my empirical analysis.

4.1 The methodological approach

When developing the causal pathway of strategy formation, I engage in theory-building process-tracing. Process-tracing utilizes a "mechanismic and deterministic understanding" of causation (Beach & Pedersen 2019: 76). Process-tracing methods are typically applied to in-depth case studies. They are useful when we want to test whether a certain causal mechanism is present or absent in the empirical data, respectively when we want to develop such a causal mechanism based on the in-depth investigation of our data (theory-testing and theory-building types) (Beach & Pedersen 2019: 69–70). A third type of process-tracing attempts to explain a particular outcome observed in the empirics (explaining-outcome type). The main difference between those three types is them being either case-centric (explaining outcome) or theory-centric (theory-testing and theory-building). This distinction tells us "whether the ambition is to generalize beyond the single case (theory-centric) or is more focused on accounting for the outcome in the single case (case-centric)" (Beach & Pedersen 2019: 69–70). Although the design of this thesis is y-centered and, first and foremost, aims at finding a plausible and convincing explanation for two specific outcomes (in three cases), it also seeks to develop a causal mechanism that can be generalized beyond these cases. This, in fact, is why I chose a theory-building process-tracing instead of an outcome-explaining process-tracing. In the words of Beach and Pedersen:

> *“[T]heory-building process-tracing starts with empirical material and uses a structured analysis of this material to detect a plausible hypothetical causal mechanism whereby X is linked with Y” (Beach & Pedersen 2019: 16).*

One situation in which it is adequate to use theory-building process-tracing is “when we know an outcome (Y) but are unsure about the causes (Y-centric theory building)” (Beach & Pedersen 2019: 16). In this instance, the analysis traces backward from Y to uncover a plausible X and infer the existence of a causal mechanism which links these two concepts (X and Y) (Beach & Pedersen 2019: 17). In this vein, this thesis, in the following chapter (5), starts from the varying outcomes of governments’ choice of strategy and traces back the process to detect a plausible explanation: starting with governments’ preferences triggered by realist/functionalist drivers, to country-specific institutional settings which induce certain coordination mechanisms between actors. By doing this, the analysis identifies different *national institutional settings* to be the X that is responsible for producing Y, *the choice of strategy*. Moreover, I attempt to demonstrate that the causal mechanism that links the institutional setting with the choice of strategy is *strategic interaction* between state and private actors. More precisely, the presence or absence of strategic interaction ultimately determines whether governments choose one strategy over the other. This theorized causal mechanism thus needs to be confirmed with empirical manifestations from the data.

However, “[e]vidence does not speak for itself”. Theory-building process-tracing “often has a deductive element in that scholars seek inspiration from existing theoretical work and previous observations” (Beach & Pedersen 2019: 17). To this end, this thesis relies on theoretical concepts from the comparative capitalism literature and previous research on privatization and the creation of global players in strategic industries (Colli et al. 2014; Weiss 2020, forthcoming).

The theorized causal mechanism that is traced in this analysis "is expected to be present across a population of cases” (Beach & Pedersen 2019: 16). Theory-building process-tracing seeks to build a theoretical argument describing a (systematic) causal mechanism that can be generalized beyond the individual case(s) to a *bounded context* (Beach & Pedersen 2019: 16). This bounded context would in the case at hand comprise other cases of transnational industry consolidation in the realm of strategic and national interest-related sectors. Potentially, it could also be generalized to cases of other kinds of governance arrangements that involve a change in ownership structure in politically sensitive areas where the question of relinquishing national control poses a risk to the state. However, building a theoretical causal argument specifically for one case (or case comparisons) can do no more than yield inference on and prove the plausibility of this exact case. Generalizing this to other cases requires further testing.

Moreover, what is certainly a limitation of this methodological approach is that "[t]heory-building process-tracing studies do not claim that the detected causal mechanism is sufficient to explain the outcome" (Beach & Pedersen 2019: 16). Thus, the existence of other causal explanations that contribute to producing the outcome cannot be ruled out. However, in order to increase the internal validity of my argument, I hold various other country-specific factors constant by selecting cases that conform to the category of liberal democratic, high income countries with membership in the European Union and relatively big aerospace and defense industries that compete on the global market (see also the following section). In addition, in attempting to rule out governments' preferences as possible explanation, I am able to increase the internal validity even further.

4.2 The case selection

The empirical analysis aims at explaining the variation in governments' choices of strategy regarding the aerospace and defense industry consolidation efforts. I selected three cases of national aerospace and defense firms partaking in consolidation activities during the investigated time period between 1997 and 2000: British Aerospace (BAe) from the UK, Aérospatiale-Matra of France and DASA of Germany. I selected these cases for the following reasons:

First of all, the three companies were the national champions of their countries in the field of aerospace and defense business at the end of the 1990s, when pressure from international competition was increasing. All three were the product of national consolidation and privatization episodes of the 1980s and 1990s. When European political leaders in 1997 decided to support the restructuring of the industry on a European level, those were (some of) the companies that were supposed to be part of this process. The main reason for this was that all three were partners in the Airbus consortium (Airbus Industries GIE). This consortium was founded in 1971 with the participation of Aérospatiale, Deutsche Airbus GmbH (later DASA), British Aerospace, and the Spanish CASA. In 1997, the governments involved in Airbus made plans to integrate the consortium into an autonomous company. Beforehand, the consortium had had no manufacturing capacities on its own but was working independently only in e.g. marketing or sales (Schmitt 2000: 22). Thus, from a commercial point of view, the complete integration of the parent companies appeared to be logical.

Second, my case selection is in line with proposed selection strategies for theory-building process-tracing. In a research situation where the outcome is known but we are unsure what it caused, and subsequently "a relatively parsimonious mechanism is uncovered that contributes to Y occurring but does not fully explain it" (Beach & Pedersen 2019: 154), a deviant case selection strategy is appropriate. A deviant case can be defined as one "that, by reference to some general understanding of a topic […], demonstrates a surprising value (Seawright & Gerring 2008: 302). My three cases are deviant in the sense that according to the general understanding of rationalist utility maximization theory, the UK and Germany would have been likely to agree to a transnational merger, since both were on the same page regarding the rejection of state shareholding, which was, in contrast, favored by France (Neue Zuercher Zeitung 1998). In addition, the UK is typically described as the European country being most open to foreign participation in British firms (James 2002: 125), whereas France, after the end of the Cold War, was known to be strongly protecting its national strategic autonomy (Matelly & Lima 2016: 64).

Third, my case selection follows a most similar systems design or Mill's method of difference (Hancké 2009; Mill 2010 [1843]). The method of difference is applied when testing for sufficient causation, where two or more cases with different outcomes are compared (Beach & Pedersen 2019: 82). "In the method of difference you select two cases that are similar in every relevant characteristic except for two, the first being the outcome that you are trying to explain […] and the second what you think explains this outcome" (Hancké 2009: 73). The conditions "that are present in both types of outcomes are then eliminated as potential sufficient conditions" (Beach & Pedersen 2019: 82). Through my case selection, I am able to hold various factors constant: first, the industry and its specific logic situated at the intersection of economics and politics; second, the companies all being relevant European players and similar in size and importance for their national governments; third, the international pressure as driver of events; and, finally, a factor that is a classical explanation of government decision-making on industrial restructuring: partisan politics (Obinger et al. 2013). I can hold the latter factor constant, since in all three countries investigated here a socialist/social democratic/Labour government leader came into power before the decisive year 1999. Lionel Jospin (Parti Socialiste) took over the French government in 1997, Tony Blair (Labour) also got into office in 1997 and Gerhard Schröder (SPD) became the German Chancellor in 1998. Thus, by holding other possible explaining factors constant, I control for intervening variables and assure that they are not causing the variation in the outcome. However, "[t]he comparativist logic of elimination does not give us any inferential leverage to determine whether a part of a mechanism is present in a particular case study, as the comparative method's use of the regularity understanding results in the actual mechanism being black-boxed" (Beach & Pedersen 2019: 82). Therefore, it is appropriate to use process-tracing methods to look into the black-box in order to comprehend the particular mechanism producing the outcome.

Yet, my research design deviates from the ideal constellation of the method of difference in one way: I do not compare two cases with different outcomes, but three cases in which two have the same outcome and an assumed similar manifestation of the independent variable, and one case that has a different outcome and also a different manifestation of the independent variable. Moreover, my hypothesis about a potential transnational coordination mechanism is outside of this structure of a case comparison and must be considered separately.

4.3 The data basis

In this short section of the chapter, I will discuss the data basis of my empirical analysis.

The process-tracing analysis, including the measuring of the dependent variable, relies on empirical evidence collected from various sources like quality newspaper articles, articles from European news agencies and specialist magazines (e.g. in aerospace). Moreover, biographical data is taken from pertinent websites. Overall, in my empirical chapter I analyze and cite more than 50 different sources of which most are newspaper articles. The sources are national and international press in three different languages: English, French and German. Thereby, I aim at covering different national viewpoints and thus avoid any national bias. The time period for my process-tracing analysis is between December 1997, when the national governments declared transnational consolidation as their goal, and October 1999, when the French and Germans agreed on a transnational merger deal. It therefore covers the complete phase of government strategy formation which ends with the final decision to conclude a deal. Finally, the search for and selection of newspaper articles and other sources was conducted according to a list of key words that was comprised of the names of the respective firms and the relevant people. The newspaper articles and specialist magazines were accessed via LexisNexis.

5 Tracing the process of government strategy formation

This chapter engages with the empirical analysis of this thesis. By performing a theory-building process tracing, I demonstrate that path-dependent national institutional settings and their respective coordination mechanisms between government and firm can account for the variation in governments' decisions for either transnational consolidation or national consolidation. In a first step, I compare the strategies of the British, French and German governments for the restructuring of their aerospace and defense industries and thereby show how the two different strategies relate to government control/influence over strategic sectors (the dependent variable). Second, I demonstrate that the three governments originally had similar preferences and, thus, I can rule out the purely preference-based explanation. Subsequently, I trace the process of strategy formation in each of my three cases and empirically map out a causal pathway of how national institutions affected the strategy formation. In this regard, I identify the coordination mechanism of the different countries as being the causal mechanism responsible for inducing the variation in the outcomes. What is more, I test my claim that transnational strategic interaction exists and may facilitate transnational consolidation.

5.1 National versus transnational champion: measuring the dependent variable

This section of the empirical analysis measures the two values of the dependent variable and, to this end, illustrates the varying choices of strategies of the three governments for consolidating their aerospace and defense industries. In this regard, relinquishing respectively retaining direct control and indirect influence by the governments is discussed.

When privatizing their national defense champions during the 1980s and 1990s, the big European arms producing countries firstly experienced delegation of control from the public to the private sphere (Weiss 2020, forthcoming). In Germany, Daimler-Benz acquired Deutsche Aerospace (comprised of the German firms Messerschmitt-Bölkow-Blohm, Dornier, Telefunken Systemtechnik) in 1989 and integrated it into its aerospace division DASA (DaimlerChrysler Aerospace Aktiengesellschaft). The company was fully privatized and the German state refrained from maintaining a veto in the corporate decision-making of DASA (Bertges 2009: 106–107). In the UK, British Aerospace was privatized during the term of Margaret Thatcher as Prime Minister in 1981 and 1985 (second floating of shares). The British government introduced the *golden share* as an instrument to preserve control over future developments in the firm (Weiss 2020, forthcoming). Comparably late, the French government decided to privatize its national champion Aérospatiale in July 1998. As part of the privatization, Matra Haute Technologies, a company belonging to the Lagardère Group, became the strategic partner of Aérospatiale and obtained 33 percent of the new company Aérospatiale-Matra. The French state maintained about 48 percent of shares and thus considerable control rights (La Croix 1999).

Hence, after the privatizations, the French government is left with a significant shareholding in the new national champion. Likewise, the UK has retained important control rights through its golden share in BAe. Only the German state fully withdrew from direct control mechanisms and surrendered its national aerospace champion DASA to private shareholders. Consequently, Germany was limited to indirect means of control (influence via regulations) at the moment of decision-making on further consolidation, whereas the UK and France were still able to retain direct control in form of shareholding.[8]

The idea of the formation of a single European aerospace and defense company (first called EADC) had been existing for years and was put in more concrete terms in 1997 when European governments were starting to campaign for such a project (Schmitt 2000: 29). On 14 October 1999, Aérospatiale-Matra and DASA (together with the smaller Spanish CASA, which DASA was acquiring) finally announced their "merger of equals" (Flight Global 1999) after only four to five months of negotiations (Interavia Business & Technology 1999). This transnational merger was a landmark deal and caught many by surprise after long-running plans to form such a transnational company (CNN Money 1999). The event marked a turning point in the period of "everyone talking to everyone else" in the European aerospace industry (Interavia Business & Technology 1999). Eventually, Aérospatiale-Matra, with the French government as major shareholder, and DASA, with the German government in its capacity as regulator, agreed to build a European champion, the European Aeronautic Defence and Space Company (EADS).[9] Accordingly, both, the French and the German government chose the *transnational champion strategy* for consolidation of their aerospace and defense firms. British Aerospace, on the other hand, had already decided in January 1999 to drop out of the negotiations with DASA about the formation of a transnational firm and instead acquired the defense business of another British firm, GEC Marconi, to become BAe Systems. The British government under Prime Minister Tony Blair, holding special veto rights for BAe, agreed with this decision, opting for the *national champion strategy* (Lovering 2000: 14).

5.1.1 National champion strategy without giving up control in the UK

During the 1990s, BAe had been allegedly the most explicit of the companies in developing a strategy for globalization. On the one hand, it was working on alliances with US firms (e.g. the

[8] Although, in theory, it would have been possible for the German federal state to negotiate a golden share arrangement for itself. This was being discussed several times later during the 2000s and in the context of a potential merger of EADS with BAe Systems in 2012 (see e.g. Spiegel Online International 2011).

[9] EADS is organized as a 50/50 holding, controlling 60 percent of the shares. The French and DaimlerChrysler each hold 30 percent with the remaining 40 percent floated on the stock market. Within the French stake, Lagardère will hold 11 percent, institutional investors 4 percent and the French state 15 percent (Interavia Business & Technology 1999).

bidding for the Joint Strike Fighter program with Lockheed Martin) and, on the other hand, it was exploring forms of cooperation with other European aerospace and defense companies. In 1997, "it was widely believed […] that BAe was about to form a new European defence-aerospace company with Daimler Benz" (Lovering 2000: 13). The two companies had already been in negotiations on a pan-European merger for months when in January 1999 BAe suddenly announced that it was merging with GEC-Marconi in order to enlarge its competences in defense electronics and form what was the then biggest defense and aerospace company in Europe (Agence France Press 1999a). Even though BAe insisted this would not mean the end to the negotiations with the Germans, DASA immediately signaled that this was a "major set-back to pan-European consolidation" (Extel Examiner 1999a).

This choice for a *national champion strategy* was unexpected by observers of the ongoing pan-European negotiations and the parallel pledges by European governments, including the British government, to move forward in defense-industry integration (The Independent: 3). By opting for this strategy, the British government was able to keep its golden share in the new BAe Systems and thus retain direct control mechanisms for influencing the future of the company via its special voting rights for important business decisions. In addition, the merger had no bigger consequences for production sites, headquarters and jobs. Everything would stay in the UK and job cuts were, if any, "minimal" (Deutsche Presse-Agentur 1999a). Hence, for the British government there was hardly any change. It now had considerable control rights in an even larger British national champion. Furthermore, the British government did not need to worry about national security prerogatives, since no foreign owner was involved in the deal.

With regard to international competitiveness and economic efficiency, BAe's acquisition of Marconi, "will undoubtedly give BAe more global clout, produce cost savings and build its strengths in electronics as well as platforms and systems" (Electronics Times Online 1999). Furthermore, BAe's geographic spread was going to change: its proportion of sales to the US market rose from 12 percent to 22 percent, while its exposure to uncertain markets in the Middle East fell from 49 percent to 34 percent (Electronics Times Online 1999). Hence, from a business perspective, this decision was positive for BAe. On the downside, however, it meant that the participation of BAe and, thus, of the UK, in a future single European aerospace and defense company was made "impossible" (DASA officials in Agence France Press 1999a). Consequently, this was crushing the British government's preferences for European (transnational) consolidation.

5.1.2 Transnational champion strategy with relinquishing control in France

DASA and Aérospatiale-Matra had been talking about alliances and a possible merger for more than two years (CNN Money 1999). One of the main issues dividing the two parties was their attitude towards state ownership. In France, "a wide consensus persists for asserting the 'superior legitimacy' of State regulation of, and methods of controlling, the arms industry" (Mampaey 2001: 125). The French state had been holding about 48 percent of Aérospatiale-Matra and needed to guarantee its influence in a potential new company because of reservations within the French population over privatizations and associated job cuts and dismissals (Richter 1999). However, both DASA and BAe were "uneasy about the French government holding a stake" in the potential European company (The Scotsman 1998) and openly communicated that they were not intending to allow the French government to hold any shares.

Eventually, the French government decided to go with a *transnational champion strategy* and merge the partially state-owned Aérospatiale-Matra with the private German DASA. The final agreement could be reached with the decision of the French government to reduce its stake in EADS to 15 percent. The reason for retaining this stake was apparently Aérospatiale's submarine-launched strategic missile capability (Interavia Business & Technology 1999), which is a strategic asset for France and a technology that is crucial to its national security interests. In this vein, the French government's veto power in EADS was being limited to decisions on "mergers and acquisitions, capital increases, and strategic partnerships" (Manfred Bischoff in Extel Examiner 1999b). Thus, this 15 percent stake with its associated veto powers equals to a golden share arrangement.

In addition, a transnational merger requires the design of an organizational structure, which reflects the shareholding structure of the firm and satisfies the interests of all parties. First, France and Germany chose a 'merger of equals' and thus *parity* regarding the structure and distribution of rights and competences (Schmitt 2000: 44). The headquarters of EADS are shared among Paris and Munich (Interavia Business & Technology 1999). Top management posts are also equally distributed among the partners: among overall 52 central management functions, 25 would be French, 23 German and four Spanish (Financial Times 2000). The integration of the two firms' businesses, however, also involved job cuts: At the end of the year 2000, a work force reduction of 1,500 jobs was discussed – about the same figure of job cuts as seen during the year 2000.[10] What is more, the closing of production sites and outsourcing of

[10] The number is for Germany and France together. However, it is unclear if this relates only to the defense unit of EADS or to the whole firm.

headquarters jobs were also part of the negotiations in this process of firm integration (AFX European Focus 2000).

By choosing the transnational champion strategy, France clearly relinquished some degree of *direct national control* over its strategic capabilities that were present within Aérospatiale-Matra. Those capabilities are now part of EADS, a transnational company with German, French and Spanish ownership (mostly via private firms). This surrendering of direct control can be observed in the reduction of the French state shareholding from originally 48 percent in Aérospatiale-Matra to only 15 percent in EADS and represents a significant change, since a 15 percent stake amounts to a golden share veto, whereas the 48 percent in Aérospatiale-Matra have meant partial state-ownership and considerable control rights and broad influence. However, the French government still succeeded in retaining at least some degree of direct control via the 15 percent arrangement. The management of EADS, on the other hand, was being shared among French and German managers, which created a rather complex situation where both sides were required to cooperate and leave some responsibilities to the other party (CNN Money 1999; Morgan 1999).

As regards the indirect influence the French government is able to exercise, EADS does not only fall within the ambit of the regulations of the French government but also within those of the German government. This is particularly important when it comes to arms exports, procurement policies etc. On the subject of arms exports regulation for instance, French and German policies differ in their restrictiveness, which could cause problems for joint manufacturing (Rinke 2019).[11] Moreover, France also gave up its sole influence on determining the distribution of manufacturing across the different sites and thus on the possibility to protect French jobs from rationalizations. These competences are now shared among the French and the German regulators.

In sum, France is only able to unilaterally block issues of change of ownership, capital increases and strategic partnerships, while smaller decisions and every-day management is now a shared responsibility among the managers of French and German nationality. Hence, France moved away from a former relatively strong priority for national security preferences and national strategic autonomy (Matelly & Lima 2016: 64) toward a consolidation strategy that favors efficiency gains and competitiveness achieved through a transnational merger.

[11] For example, in 2019, Airbus CEO Tom Enders urged Germany to ease its export ban on Saudi Arabia by threatening to build 'German-free' products.

5.1.3 *Transnational champion strategy with relinquishing influence in Germany*

The German case differs from the French and the British cases in that the German national champion DASA is a completely privatized firm without any state shareholding or golden share. Accordingly, the German government never had direct control over business decisions of DASA since its foundation as a private company in 1989 (Bertges 2009). However, the German government of course acted as a regulator vis-à vis DASA and thus indeed had significant influence on the firm and its development.

With DASA, DaimlerChrysler has owned the largest company in its sector in Germany. Yet, defense and aerospace had little place in West Germany in the years immediately after the second world war and the industry did not receive the same attention as in other countries, especially compared to the US (Financial Times 1995). During the 1990s, DASA was in a difficult financial situation and “German industrialists and politicians fear[ed] that the country's aerospace industry may be in terminal decline and may be impossible to rescue even with the most radical restructuring” (Financial Times 1995). Hence, for the DASA management and the German government alike, it was clear that consolidation was a necessary step to guarantee the survival of the industry. Consequently, DASA started looking for strategic partners and since “has been at the forefront of moves to consolidate European defense and aerospace interests” (Aerospace America 1998).

Concerning the task of restructuring the aerospace and defense industry, DASA had in the past profited strongly from its existing involvement in projects such as Airbus, Eurofighter, and Eurocopter. Also, these forms of transnational European cooperation were strongly encouraged by the German government (Brzoska 2000: 42). What is more, DASA has had rather few ties outside of Europe and “remains uneasy about consolidating its global position outside of the EU trading block” particularly when it comes to the military segments (Aerospace America 1998). Within the European sector, the German government’s main goal was to achieve full privatization of the Airbus consortium in order for it to be able to compete with the US champion Boeing. Yet, “efforts by Germany and Britain to get Airbus transformed into a joint-stock company ha[d] been thwarted by France's insistence on retaining considerable ownership of Aerospatiale” (Deutsche Presse-Agentur 1999c). As a consequence, DASA favored BAe to be its partner in a transnational merger that would form the basis for restructuring Airbus. However, after BAe broke off merger talks with DASA in January 1999, when they were close to completion, by opting for an all-British tie with the purchase of GEC's Marconi defense arm, DASA executives were infuriated by the move (CNN Money 1999) and a merger with the British firm receded into the far distance.

By merging with Aérospatiale-Matra in 1999/2000, DASA, with the agreement of the German government as the regulatory authority, opted for the *transnational champion strategy*. One of the central questions in this process was how to balance and preserve the German and French national interests in the shared company (Spiegel Online International 2011). In contrast to France, Germany had no direct stake in its national champion DASA and thus had also no direct stake in the Airbus consortium. However, as regulator, the German government had considerable influence as regards the future ownership of one of its most strategically important aerospace and defense companies. This is possible through an important legal instrument, the Foreign Trade Act (Außenwirtschaftsgesetz): it stipulates that foreign companies must register their interest with the German government when they intend to attain more than 25 percent of a German defense company (Brzoska 2019).

Nevertheless, by merging the two companies, the German state was surrendering some degree of influence over its strategic assets. The firm structure "with joint Franco-German chairmen and joint chief executives in Paris and Munich" (Financial Times 2002) left the German government dependent on coordinating with DASA managers who, in turn, have to deal with French state interests as well as with French private interests represented by Lagardère. Hence, implementing its own interests in the defense sector had become much more complicated and challenging for the German government. This was not only valid for the subject of protecting jobs and production sites in Germany but also for export and procurement preferences. However, Germany still "does have considerable influence over Daimler when it comes to control of EADS" (Spiegel Online International 2011). This is particularly important in light of potential problems that could arise from cultural differences on the German and French sides (Morgan 1999) and German fears of French ambitions for leadership in EADS (Financial Times 2002) and the European defense industrial base in general.

In sum, the German government has made a decision in favor of supporting DASA in its plan to achieve economic efficiency gains which will help its survival in the global market as part of a pan-European company. However, with this decision the German state surrendered some degree of national regulatory influence over a strategic firm that is clearly linked to its national security interests. The new cross-border firm was going to be more difficult to regulate via national institutions than the national champion DASA had been. Particularly the French state shareholding was considered to be worrying DASA officials as well as German politicians (The Scotsman 1998).

In this section (5.1), I have presented empirical evidence to demonstrate the variation in governments' choices of a consolidation strategy (national or transnational) and their implications for national control. In the following sections, I will engage with explaining this variation.

5.2 Ruling out the preference-based explanation

In order to fully account for the variation in governments' strategies, the empirical evidence must yield that the preferences of each of the governments can directly be translated into their respective strategies. However, this is not the case for the governments investigated in this thesis. Even though national security interests certainly play a role for all European states, this role might differ slightly in terms of prioritization. Referring to national cultures, France is said to have a preference for national autonomy and state control at the cost of transnational cooperation – opposed to Germany and the UK, which are allegedly more open to privatization and foreign participation in their industries (see e.g. Mampaey 2001; James 2002; Matelly & Lima 2016). Yet, at the end of the 1990s, the globalization of the aerospace and defense industry had created a strong pressure that *uniformly* affected the big weapons producing countries and triggered a *similar* government response across these countries. This was reflected in the fact that the three governments, French, German and British, all preferred to create a transnational company.

In December 1997, French President Jacques Chirac, German Chancellor Helmut Kohl and British Prime Minister Tony Blair jointly announced their "vital political and economic interest in an efficient and globally competitive European aerospace industry". They saw the "urgent need to restructure the aerospace and defense electronics industries", which should "lead to European integration based on balanced partnership" and serve the aim of improving "Europe's position in the global market, to promote European security, and ensure that Europe will play a full role in its defence" (declaration cited in Adams et al. 2001). The political leaders all emphasized the goal of efficiency and competitiveness and reframed the security question not as a national but a European matter. Thereby, they situated themselves at the 'efficiency'-end of the scale and determined their preference for transnational cooperation and consolidation. National security indeed seemed to play an important role in this decision, however, it was taken out of the pure national context and thus was no longer an impediment for transnationalization. As part of this declaration, the British, German and French governments asked their national champions to present to them a detailed plan on how to implement the European restructuring. In the subsequent months, the companies worked on the vision of a single European company (first called EADC) (Schmitt 2000: 29–30).

Since the three governments had *similar preferences* for consolidation, namely for transnational consolidation, this leads to the notion that an explanation purely based on governments' preferences cannot account for the variation in the choices for a consolidation strategy. Within my research design, testing for this explanation amounts to eliminating an alternative explanation. Even though preferences always play a certain role, they are not decisive in explaining the variation in the outcome. Hence, other causal factors such as the effects of interaction with private actors need to be considered in the analysis. This will be done in the next section of this chapter.

5.3 The institutionalist explanation of variation in consolidation strategies

Since neither existing explanations that deal with the drivers of consolidation, nor purely preference-based explanations can account for why France and Germany decided for a transnational merger, whereas the UK withdrew from this joint economic and political project and chose a national merger, I trace the causal pathway of government strategy formation and develop an institutionalist argument to make sense of the varying outcomes. By conducting the process-tracing, I analyze the interaction between government officials (public actors) and national industrial managers (private actors) in order to identify the mechanism that is responsible for the respective outcome. In this vein, I present empirical evidence for the respective institutional setting of each of the countries and its impact on the process investigated here. I start with the British case study and why the UK opted for a national champion strategy, followed by the French case study and subsequently the German case study and the explanation of why both chose a transnational champion strategy. Finally, I demonstrate the emergence of a transnational coordination mechanism.

When deciding on *how* to consolidate their aerospace and defense firms in light of international competitive pressures, managers face coordination problems with their stakeholders (Hall & Soskice 2001: 6), particularly with their most important stakeholder: the government. From the government's perspective, this coordination problem is crucial. Considering the strategic nature of this industrial sector, governments have critical interest in influencing major business decisions of the respective firms, especially decisions about changes in ownership. As elaborated above, since the firms investigated here are private firms, government representatives are left to coordinate with managers and industrialists on the right strategies to respond to the challenges of globalization. Eventually, the historically grown and country-specific coordination mechanisms affect which of the actors prevails in this process of strategy formation.

5.3.1 British institutions and the strategy formation process

In the United Kingdom, the interaction between government and business is characterized by an *arm's length*-relationship. The government usually does not intervene in business decisions and considers its role to be that of a preserver of free market forces and a rather distanced rule setter (Schmidt 2009: 521). However, since the privatization of British Aerospace in the 1980s, the British government has a golden share in the company (Weiss 2020, forthcoming). This is somewhat contradictory to assumptions of the state remaining on the sidelines of decision-making. Regarding the institutional support and management of relationships in the defense industry, the UK lacks an organization comparable to the French Directorate General of Armaments (DGA), which centralizes and structures procurement processes (DeVore & Weiss 2014: 499).

After British Prime Minister Tony Blair had joined the Franco-German-British declaration to build a transnational aerospace and defense giant in December 1997 (Adams et al. 2001), British Aerospace "was noisily insisting that it was committed to develop a pan-European defence-aerospace company which would bring it alongside all Western Europe's significant aircraft and defence electronics companies, explicitly including […] DASA" (Lovering 2000: 14). DASA has always been the most logical continental partner for British Aerospace (The Times 1999). This is not only the case since they had already established a close relationship (Lovering 2000: 14), but also because both are private firms and thus have less cultural differences between each other compared to for instance with the state-owned Aérospatiale (Neue Zuercher Zeitung 1998). Talks between British Aerospace and DASA had been stopping and starting since 1995, and finally, the two sides came close to an agreement shortly before Christmas 1998 (The Times 1999).

However, quite suddenly, the events took a different turn. In late December 1998, the British company GEC (General Electric Company) under the leadership of George Simpson decided to sell its Marconi defense electronics unit to BAe and Sir Richard Evans, chairman of BAe, decided to buy it (Heller 1999; Lovering 2000: 14). DASA reacted immediately and announced that now that BAe opted for a British national merger, the foundation for a British-German merger would have been destroyed. Probably the most central reason for the cancellation of the merger plans by DASA was the mismatch in size between DASA and the new BAe: after the merger with GEC's defense unit, BAe was going to be much more valuable than DASA, which would render a merger on equal terms nearly impossible and make DASA a junior-partner in the alliance (Deutsche Presse-Agentur 1999b; Heller 1999). Although BAe said it still wanted to link with DASA, DASA management warned that the BAe-Marconi deal "will make balanced European horizontal mergers such as Dasa-BAe impossible and create an obstacle to European integration" (DASA officials cited in The Times 1999).

How did the British government react to the sudden change of plans of British Aerospace which was opposed to its own preferences of building a European champion and, moreover, would make this plan potentially impossible for the future? Prime Minister Blair responded by criticizing British Aerospace's takeover of Marconi: He allegedly told BAe chairman Richard Evans that he would have preferred a more European approach by BAe (Deutsche Presse-Agentur 1999b; The Times 1999). Blair furthermore remarked that "[t]he BAe-Marconi deal was 'too British'" (Deutsche Presse-Agentur 1999b). Others reported that Blair would have adopted a "careful neutral stance" towards the BAE-Marconi deal, being quoted as saying "I am not interfering with the commercial decisions of those companies" (Agence France Press 1999b). Hence, Blair endorsed British Aerospace's new strategy to become a "primarily British defence giant instead" (Lovering 2000: 14), although he had had different plans for this strategic company. Interestingly, due to the British state's golden share in BAe, Blair would have had the possibility to veto the merger of the two British companies and assert his and his government's preference to have BAe merge with DASA and later potentially with Aérospatiale-Matra into a transnational company. On the contrary, instead of the government, the private company shaped the direction of restructuring the British aerospace and defense sector. For the public, this passivity of the government was being framed as "willingness to accept the decisions of the 'market'" (Lovering 2000: 17).

The British government and Tony Blair decided not to intervene in a business decision of British Aerospace, even though it was a decision about changes in ownership, which is an area covered by the veto power of the holder of the golden share. This is in line with the expectations of the theory that a government in a liberal market economy would consider itself to be 'liberal' in the sense that it would not interfere in corporate decisions and instead maintain its arm's length-relationship with firms, even if the firm is of strategic importance for the economy and national security alike. The examination of the data shows that Blair refrained from interacting with BAe's managers on the issue and accepted the result without trying to change it. Indeed, the government had first supported BAe in its attempt to negotiate a merger with DASA and when BAe decided otherwise, Blair endorsed this change in strategy in spite of his clear and officially communicated criticism of it. The passive behavior by Blair prevented a possible alignment of interests between BAe managers and the British government. There was no joint coalition of actors of both sides, state and private, that advocated for the implementation of a European merger with British participation. In this vein, "the Blair government has gone much further down the road of 'hands-off' defence-industrial strategy than any other European Union member" (Lovering 2000: 17).

Hence, in the UK, private actors prevailed in the strategy formation process and were free to implement their preferences for consolidation. The government simply confirmed this strategy by staying out of the decision. Thus, BAe withdrawing from the pan-European consolidation project was a business decision against participating in European defense-industrial integration and in favor of an orientation towards the US industry (Neue Zuercher Zeitung 2000). Accordingly, the choice for a national champion strategy was not a (political) choice for prioritizing national security interests but a choice in favor of a subsequent transatlantic cooperation effort, which might encompass efficiency gains just like a European cross-border merger would have done. From the perspective of the British government, there was no need to intervene in the business decision, since as discussed above, the national champion strategy did not include any surrender of national control over British Aerospace. The state could keep its golden share and thus maintain some degree of direct control over important strategic choices of the firm.

However, the choice for a national merger meant that the UK was isolated in European aerospace and defense consolidation endeavors and "cold-shouldered" by its European allies when DASA and Aérospatiale-Matra eventually came to a merger agreement in October 1999 (Sunday Times 1999). The result of Blair's non-intervention was that the UK was excluded from the political project of building a European champion, which was about to be a crucial part of the development of a European technological and defense industrial base.

The tracing of a plausible causal pathway of government strategy formation shows that the coordination between state and private actors can determine which of the actors is able to assert its preferences for consolidation. In the British case, due to a lack of strategic interaction between the actors and the government's unwillingness to intervene, BAe's preference was implemented and British participation in the transnational consolidation failed.

5.3.2 German institutions and the strategy formation process

Historically, the German defense industry was able to grow relatively big and important due to a considerable amount of state subsidies (Brzoska 1989: 501). It was always well-protected and well-supported by the German state with a "'cosy' relationship between the defence set of companies and procurement decision-makers" (Brzoska 2000: 34). When the German aerospace industry was privatized in the 1980s, the state played an active role in supporting Daimler Benz with the acquisition of Messerschmitt-Bölkow-Blohm by giving it initial guarantees for orders and protection against financial risks, in exchange for Daimler's guarantee to preserve jobs. Thus, from the beginning on, DASA was encouraged by the state to be the leading national champion in the aerospace sector. Even though the industry has since been almost completely transferred to private hands, it has nevertheless been under "fairly strict governmental control" (Brzoska 2000: 36–37). However, as already elaborated on earlier in this chapter, control (or influence) was exerted via more indirect, informal ways, like procurement regulations, competition policy, and government oversight (Brzoska 2000).[12]

Although the German aerospace and defense industry is said to be rather "low profile" (i.e. not very visible) and well-integrated into the German civilian sectors, it is a "highly protected industrial sector" very much "isolated from competitive pressures" (Brzoska 2000: 43–44). This particular structure of the industrial organization of the sector enables companies to lobby rather easily for procurement tenders and government protection. Hence, one can say that "[t]here was a weak, informal form of a 'military industrial complex' in the sense of a close network of decision-makers in the armed forces, parliament and in certain companies" in Germany (Brzoska 2000: 43). This informal network is moreover strengthened through coordinative intermediary institutions that characterize the relationship between government and industry in Germany: industry associations, labor unions and political 'control centers' in ministries and government agencies that deal with defense and aerospace matters. For instance, the aerospace and defense companies organize their joint representation in the German Aerospace Industries Association (Bundesverband der Deutschen Luft- und Raumfahrtindustrie, BDLI) as well as in a special group within the Federation of German Industries (Bundesverband der Deutschen Industrie, BDI) , which is the leading association for the German industry at large (Brzoska 2000: 44). Since DASA was part of the big German car manufacturer DaimlerChrysler (earlier Daimler-Benz), it automatically had access to a large

[12] Important oversight bodies are the Ministry of Defense, the Parliamentary Committee for defense matters, the Federal Audit Office, and the Ministry of Economics as regards the "Kriegswaffenkontrollgesetz" that regulates e.g. arms exports (Brzoska 2000: 37–38).

network of important contacts, inter alia through its representation and significant status within the BDI.

On the part of the German state, the main person responsible for the governance of the aerospace sector and thus also for mergers and acquisitions in this industry was the Parliamentary State Secretary in the Federal Ministry for Economics, Siegmar Mosdorf. At the beginning of his career as an industry expert, he was working for the labor union IG Metall and was advising, among others, members of the supervisory board and the works council of Daimler-Benz (Munzinger 2019). This suggests that during this time, he was able to establish contacts to members of the worker's representation as well as potentially also to Daimler management; this might have proved valuable for coordinating with company representatives later on. Even though the official supervision of the consolidation effort was in the hands of Mosdorf, one can assume that direct discussions with DaimlerChrysler chairman Jürgen Schrempp were also personally conducted by German Chancellor Gerhard Schröder. Schröder was oftentimes referred to as "Wirtschaftskanzler" (FAZ 2001) by his critics and the press, indicating that he was very industry-friendly, especially as a social democratic politician.

Schrempp, who was leading the coordination with the German government as well as the negotiations first with British Aerospace and later with Aérospatiale-Matra, was a powerful figure in the German industrial landscape. He was awarded 'manager of the year 1998' by the Manager Magazin for being the architect of the spectacular merger of Daimler-Benz and Chrysler (Der Tagesspiegel 1998). He can rely on an extensive network including business as well as personal contacts. Next to Schrempp, Manfred Bischoff, CEO of DASA, was the person in charge of merger talks and strategy formation on the side of DASA.

Although the German federal state does not have an agency or ministerial department responsible for the aerospace and defense industry that is as centralized and powerful in linking political and industrial representatives as the French Direction générale de l'Armement (DGA) (Brzoska 2000: 37), industrial and state actors in Germany are connected through the existing intermediary institutions and informal networks. Within these forums, exchange of information, reputation management and strategic coordination is possible. Especially business associations and big companies enjoy privileged access to lobbying politicians and bureaucrats. This is particularly valid for automotive companies like Daimler (Süddeutsche Zeitung 2017) and the

German defense industry (Abgeordnetenwatch.de 2015).[13] This 'special' relationship between state and private actors originates in the German *corporatist* system, in which the state functions as an arbitrator between business and labor interests, and business associations are (informally) involved in the formulation and even implementation of public policy functions (Streeck 1983). Hence, strategic interaction between state and private actors in Germany is highly institutionalized albeit much more informal and less hierarchical and centralized as compared to France with its DGA.

After DASA was ditched by BAe in January 1999, it announced that it would "evaluate its other European and transatlantic options" (Watson 1999). However, a merger between DASA and BAe had looked so attractive since both companies were much further ahead in restructuring and rationalizing their businesses compared to other European firms like the French (Watson 1999). DASA allegedly also was in initial talks with US firms like Lockheed, Northrop or Raytheon (Heller 1999; Sunday Times 1999). Yet, how realistic a transatlantic merger was at that point in time remains unclear. Nevertheless, the fact that DASA had other options besides a European merger pressured France to initiate talks about a merger with Aérospatiale-Matra. Still, the problem of the French government insisting on keeping its state shareholding and enormous influence over the company was impeding actual negotiations (Heller 1999).

In Summer 1999, the secret negotiations between Schrempp and Lagardère resulted in a draft deal that, however, did not include French state shareholding (more details in the following section 5.4). Obviously, the French government strongly disapproved of this deal. DASA reacted by consulting the German state to give "political backing" to the DASA management because "it feels that as a private company it would not be able to negotiate with the French state" (Agence France Press 1999c; Associated Press International 1999). In this situation, Siegmar Mosdorf as representative of the German federal state took center stage: Mosdorf declared that the German government's priority was to transform the Airbus consortium from a loose marketing association into an integrated European aviation group (Agence France Press 1999c). One way to achieve this was to support the potential linkup of DASA and Aérospatiale-Matra – which the government did. To his end, Mosdorf tried to create political pressure in Paris to clear disagreements and facilitate a deal between the two companies. The German government argued that it felt a sense of urgency because Airbus' chief competitor Boeing was expected to soon overcome its period of weakness: "We have to pick up our pace on this"

[13] The sources are from 2015 and 2017 for reasons of availability of data. It is assumed that this pattern was not very different in 1999/2000. The article by Abgeordnetenwatch.de collects data on lobbyists' access to the German Bundestag.

(Associated Press International 1999), Mosdorf allegedly said in Paris where he and even Chancellor Schröder went to convince the French government to reduce its stake (Deutsche Presse-Agentur 1999c; Der Spiegel 1999b).

Hence, the case of the German government working together with DASA management to achieve a concession by the French government (reduction of its stake) is an example of how strategic interaction of state and private actors on a national level – enabled through coordinative institutions like business associations, informal networks and personal contacts – induces an alignment of interests and the formation of a national coalition for transnational consolidation. Moreover, the German state intervened in a cooperative and supporting way to facilitate the economic activities of its national aerospace champion.[14] Thereby, it contributed to the success of the deal in its role as a facilitator.

Yet, there was another actor whose consent was crucial in a decision on a potential merger: the works council (Betriebsrat) of DASA. In order to win it over for the consolidation endeavor, Parliamentary State Secretary Mosdorf emphasized that no jobs would be cut, since the merger was going to be a merger for growth ("Wachstumsfusion") (Spiegel Online 1999). The works council had already accepted the company's downsizing and cost-cutting measures before, and was now joining in "the general jubilation over the merger, placing its hopes in a restructuring of the Airbus consortium that is to accompany the corporate union [EADS]" (Richter 1999). The works council commented that it realized the necessity of such a merger in the aerospace and defense industry and that it was confident that employees' rights of co-determination were being protected under the deal (Spiegel Online 1999). Mosdorf had engaged in coordinating with the worker's representation and succeeded in convincing them to join in the support for the transnational consolidation effort. Thus, the national coalition for the transnational champion strategy was comprised of DASA managers, the DASA works council and German government representatives. This was a collation potentially strong enough to get concessions from the French government.

In sum, in the German case study, none of the actors prevailed and pushed through its preferences. By contrast, public and private actors aligned their interests and shared the goal of becoming part of the future European aerospace champion, which should in their view include as little French state shareholding as possible. Although DASA is a fully privatized company, their managers and German state officials emerged as one coalition campaigning for the same

[14] Here it is important to note that since the German government was not a shareholder of DASA, hierarchical intervention was not really likely.

strategy. Due to this agreement and the cooperative relationship between the actors, the German government was ready to relinquish political influence over its strategic assets, which were merged into a transnational company in which DASA and DaimlerChrysler managers would be the representatives of the German part of the company.

5.3.3 French institutions and the strategy formation process

The strong commitment of the French state in its economy has a long tradition and its role is even more active and significant in the defense industry, which has been "the spearhead of the national industry" (Serfati 2000: 20). The presence of the government in the economic relations in France has contributed to the general slow speed of restructuring the defense industry (Mampaey 2001: 124). What characterizes the French defense industry is its organization "through a tight knit relationship between state technical agencies, public and private industry, and the General Delegation for Armament (DGA)" (Serfati 2000: 20). Particularly in the defense industry, we can observe that actors are connected through non-market relationships (Serfati 2000: 21). The DGA is the main instrument of intervention by the French state: it organizes procurement, manages R&D and operates a network of industrial actors (Mampaey 2001: 127–128). Moreover, the DGA serves as a means to mitigate uncertainties as regards economic activities in the sector. Thus, it directs what Serfati calls the French "meso-system of arms production" (Serfati 1992), in which the DGA plays a powerful role.

The French political sphere and the French industry are linked through a network-like structure. The relevance of these elite networks originates in France's institutional arrangements such as "low trust, concentrated power relations and state-run elite education" (Yoo & Lee 2009: 529). The networks improve the "coordination efficiency of economic relations through state activism", thus representing an alternative to high trust social capital (Yoo & Lee 2009: 529). With regards to the French financial sector, it has been confirmed that social prestige and club membership define who is part of the inner elite circle. Likewise, having important contacts and friendships in political and industrial elite circles is influenced strongly by whether one attended the *grandes écoles*, especially the *École Polytechnique* and the *École nationale d'administration* (ENA), which regulate access to the French senior civil service and thus trains the *corps* (highest rank of administrative personnel) (Kadushin 1995: 202; François & Lemercier 2014: 155). This is also true for the strategic aerospace and defense industry. Despite privatizations in a strategic industrial sector, strong personal ties among elites can guarantee stability of the system through "enforceable trust" (Kadushin 1995: 202). Furthermore, apart from joint experiences in the state-run elite education system, the mechanism of 'pantouflage', a French expression for 'revolving doors', i.e. the transition from public administration to high-rank private sector positions, is a wide-spread phenomenon in France (Charle 1987; François & Lemercier 2014: 155). In sum, recruitment into elite networks in France depends highly on membership in a series of institutions: Family, educational institutions, corporate and professional organizations and state institutions (Harvey & Maclean 2008: 116).

The significance of French elite networks persists. Many of the top managers that were involved in the privatization of Aérospatiale and in the subsequent negotiations with DASA are former members of the civil service. This speaks to the notion that these elites "were only created to impose State supervision on the entire economic body" (Mampaey 2001: 129). On the French side, Jean-Luc Lagardère, his right-hand man Philippe Camus, Aerospatiale's director for strategic planning Jean-Louis Gergorin, Frederic Lavenir, deputy to Finance Minister Dominique Strauss-Kahn, and Strauss-Kahn himself were the key actors in the negotiations with DASA (Interavia Business & Technology 1999). All of them were equally involved in Aérospatiale's merger with Matra in 1998 and early 1999. Camus was employed at the public *Caisse des dépôts et consignations* before he started working for the Lagardère Group, thus switching from public to private sector employment. Likewise, Gergorin had been working for the French Ministry of Foreign Affairs before changing to Matra at the Lagardère Group. All of the actors attended some state-run elite school: Gergorin and Lavenir studied at ENA, where Strauss-Kahn worked as a professor, Camus and Strauss-Kahn went to Sciences Po Paris and Gergorin as well was a student at the École Polytechnique.[15] Hence, all of the French key actors in the transnational merger negotiations were part of an elite network built around the aerospace and defense industry.

When the Socialist government under Premier ministre Lionel Jospin took office in 1997, it wanted its national champion Aérospatiale to participate in the European consolidation of the aerospace and defense sector, which was about to take place (see the political declaration in Adams et al. (2001)). In order to strengthen France's bargaining position in the upcoming talks with potential partners like BAe, DASA, CASA, Alenia, or SAAB, the government's goal was to build a strong French aerospace pole around state-owned Aérospatiale to reinforce its role as a national champion, like other European states had done it before (Cour des comptes 2013: 68). During the year 1998, the threat of a marginalization of the French aerospace industry, i.e. France being left out in a European merger, was steadily increasing, since DASA and BAe were

[15] Here, I rely on a dataset of biographical data that I collected myself on actors in the French elite network around the aerospace and defense industry. The primary data stem from websites like Wikipedia, Bloomberg and others.

in talks about a two-way merger and strongly insisting that any merger with French participation would require a privatization of Aérospatiale (Libération 1998; Neue Zuercher Zeitung 1998). The French government was worried that the UK and Germany "would go it alone if the French partners don't move quickly enough" (Extel Examiner 1998). The French perception was that the UK was trying to get between the "traditionally cosy Franco-German axis which had long been the cornerstone of European politics" (Clift 2002: 170). Hence, Jospin feared that France would become isolated in Europe if it was not part of the European consolidation efforts and plans of integrating the Airbus consortium (Schmitt 2000: 32–33). Consequently, he implemented the privatization of Aérospatiale by merging it with the private company Matra. This move was opposed to the initial agenda of the Parti Socialiste, which intended to stop privatizations in general (Parti Socialiste 1997: 7). Although the (partial) privatization was only a reduction of state shareholding to 48 percent, it was meant as a signal towards France's European partners to show that it was willing to compromise in order to achieve the common goal of cross-border consolidation (La Tribune 1998).

Hence, privatizing Aérospatiale was a means for the French government to realize its preference of being part of European transnational consolidation. The way it accomplished this plan was by hierarchically choosing a private partner for Aérospatiale. For this task, Jospin and his Minister for Defense, Alain Richard, relied on their network and selected among several alternatives (Dassault, Thomson CSF) Matra, which was part of the Lagardère Group. By choosing Jean-Luc Lagardère as partner, the government decided in favor of someone with very good connections to other European industrial leaders. Moreover, Lagardère had built up numerous transnational collaborations across Europe and, most importantly, an alliance with DASA, which was the historical partner of Aérospatiale (Le Point 1997). This alliance rendered Lagardère indispensable for the plans of the Jospin-government. The government was clear about its intentions to let the new company benefit from the experiences and relationships of Jean-Luc Lagardère (Börsenzeitung 1999). As regards a possible European merger, Lagardère was supposed to be helpful in the negotiations in his role as president of the supervisory board of Aérospatiale-Matra (Libération 1999).

In the French case, the alignment of interests between the public authorities and the private industrial actors and their establishment of a national coalition that promoted the transnational consolidation strategy was hierarchically arranged. Lagardère was selected exactly for the reason of being supportive of and useful for the transnational consolidation strategy. Jospin and his ministers and aides used the elite network comprised of government officials and aerospace managers strategically to push through their preferences. The French government arranged the 'marriage' with Matra having in mind the next step of a European merger. The outcome of the government strategy for consolidation was thus mainly possible because the French elite network structure that connects the relevant actors enabled them to interact strategically and align their preference in favor of European consolidation. In comparison with the German case, the strategic interaction was however characterized by considerable French state intervention in the form of hierarchical arrangements. Hence, the French government confirmed its role as being an *influencing* or *enhancing* actor in the economic activities of its strategic industries.

5.4 Strategic interaction as transnational coordination mechanism

This section of the empirical chapter analyzes whether strategic interaction as a causal mechanism can not only be observed on a national, but also on a transnational level, i.e. as coordination between elites of different countries (Hypothesis 3). First, I briefly summarize the findings of section 5.3 on which my process-tracing analysis of the transnational interaction builds. Second, I trace the transnational negotiation process and look for the presence of strategic interaction on the transnational level and its impact on the outcome of the negotiations.

The Varieties of Capitalism approach makes theoretical assumptions about national politico-economic institutions which affect the economic and policy outcomes in their respective country. It emphasizes national institutional differences which persist amid globalization pressures (Hall & Soskice 2001; Schmidt 2003; Schmidt 2009). Nonetheless, the two types of coordinated market economy and state-influenced market economy have many institutional characteristics in common, as has been demonstrated in the above case studies on Germany and France. In Hall & Soskice (2001) they are even treated as one type of capitalism (the CME). Both types rely on strategic interaction in their coordination between public and private actors. Germany as CME coordinates via informal networks and intermediary institutions. In France, a SME, on the other hand, strategic coordination is enabled via strong elite networks that are historically grown due to state-run elite education and the *pantouflage* mechanism (François & Lemercier 2014).

The process-tracing analysis in the preceding section has dealt with the coordination process on a national level and with the outcome of a national government's consolidation strategy. However, the causal mechanism of strategic interaction may also be present on a transnational level, if both nations' institutions provide the actors with the conditions for strategic interaction. Since both, France and Germany, have got network-like structures that promote exchange among the public and the private spheres, the coordination mechanism might also be elevated onto the transnational level, resulting in strategic interaction across borders via a transnational network of actors. In the age of ever closer European integration and economic globalization, economic activity of European firms is increasingly transboundary. Consequently, there is an emerging network of transnational industrial elites due to growing industry representation and lobbying efforts at the EU level as well as elite socialization through exchange in different transnational forums or 'planning groups' with top executives of transnational corporations and key political and opinion leaders (van Apeldoorn 2004: 159).[16]

The negotiations about a possible merger between DASA and Aérospatiale-Matra were initiated and conducted by a well-coordinated team of French and German actors from June 1999 onwards. This team was comprised only of the representatives of the two firms, initially excluding any government officials. The negotiations were conducted in secrecy and at changing places across Europe (Focus 1999). The actors involved on the French side were Jean-Luc Lagardère, Philippe Camus and Jean-Louis Gergorin, all managers originally coming from the private company Matra. On the German side were DaimlerChrysler chairman Schrempp, DASA CEO Manfred Bischoff and MTU president Rainer Hertrich (Interavia Business & Technology 1999). The one issue that was impeding a fast closing of the deal was the French state's shareholding. In the unfolding events, Schrempp and Lagardère became the key actors of this negotiation, both of them acting as mediators between the different fractions. Schrempp and Lagardère have known each other for a long time, as both are leaders of an 'industrial empire'.[17] Since Daimler had bought four percent of Matra shares some years ago and took over one seat on the supervisory board, they were meeting regularly (Der Spiegel 1999a).

By July 1999, the French government had agreed to cut its stake to 20 percent to facilitate an agreement with DASA. But the talks stumbled because the Germans demanded the state shareholding to be renounced completely. The question was whether Schrempp, on the one side, and Jospin, on the other side, would reach a compromise (Sunday Times 1999). At this point, Lagardère stepped in and lobbied the French government. He persuaded Strauss-Kahn to reduce the government stake to 15 percent in order to be able to finalize a deal. Without the intervention by Lagardère, an agreement would not have been reached, said a DaimlerChrysler manager in the Focus (1999). On the other hand, Schrempp had to mediate between Lagardère and Jospin, since the latter wanted to prevent Lagardère from obtaining one of the two leading

[16] Within political science debates, this focus on the role of transnational societal actors such as business elites is associated with the theoretical tradition of neo-functionalism (Haas 1968; van Apeldoorn 2005).
[17] Lagardère ownes the Lagardère Group including a big publishing group, Hachette, and the participation in Aérospatiale-Matra.

positions on the board of the future company. Like Schrempp, Lagardère was not pleased with any state shareholding in EADS (Der Spiegel 1999a), which in turn was a problem for Jospin. Jospin had to choose between retaining control of the aerospace and defense sector, a national 'holy shrine' for the French, and being part of an internationally competitive European company (Der Spiegel 1999b).

In the end, the parties achieved a compromise: The French state reduced its stake, which was a major concession for a French government to make, since it meant relinquishing some degree of control over a strategic firm. The Germans also made concessions by agreeing to a transnational company that still included state shareholding. However, this was the price to pay for the Germans (Bischoff: "die Kröte, die sie schlucken mussten") to realize their preference of transnational consolidation (Der Spiegel 1999b). Yet, the Germans managed to include a withdrawal option in the contract, which states that DaimlerChrysler is able to sell its shares to the French partner at market rate, if the French state blocks necessary rationalizations (Der Spiegel 1999b). Thus, DASA has ensured that it is protected against any major disagreements if the differences in the corporate cultures would become damaging to the cooperation.

The decisive factor that made the deal and thus the merger possible was the *transnational coalition* between Schrempp and Lagardère. They initiated the negotiations between the two firms and conducted them without participation by the governments in order to first find common ground and achieve alignment of interests between the private industrial actors before including the complex questions the governments would bring in. This strategic interaction proved successful. Their coalition, later with support of the German government, was able to convince the French government to reduce its control rights. This concession by France eventually allowed the actors to reach a compromise and agree to a transnational merger.

Strikingly, the negotiations only lasted between four and five months overall (Sunday Times 1999) and the initial talks between the managers of both firms yielded a first agreement after only eight weeks (Focus 1999). Compared to the Aérospatiale-Matra merger for example, which took about eight months, this deal was closed exceptionally fast (Interavia Business & Technology 1999). Against the background of the complexities that a cross-border merger brings along and which need to be agreed on in the deal, this outstanding rapidity is an indicator for successful strategic coordination among the actors. "There is a big 'Trust me' in this deal, particularly with the French government retaining a stake," commented an expert in CNN Money (1999). Apparently, the transnational actors Schrempp and Lagardère achieved creating this trust through their personal link, common interest and strategic interaction.

6 Conclusion

In the concluding chapter, I first summarize my main empirical findings and assess that I was able to confirm my hypotheses 1 and 2 about the varying implications of different national institutional settings, while having found preliminary indications for my hypothesis 3 on the transnational coordination mechanism. Subsequently, I elaborate on the contribution of my findings to existing research. Finally, I discuss potential limitations of my thesis and outline avenues for future research.

6.1 Empirical findings

The goal of this thesis was to make sense of differing government responses to the growing demand for consolidation of the aerospace and defense sector in Europe. In 1997, several European governments committed themselves to the project of a single European aerospace and defense company. In the end, we could see the creation of a European champion, EADS. The outcome was a Franco-German firm with a small Spanish participation. The United Kingdom, however, opted out of the joint project and strengthened its national champion BAe to be one of the leading defense companies worldwide with an orientation towards the US market.

In the first section of the empirical chapter (5.1) I demonstrated that by opting for the transnational champion strategy, Germany and France accepted to surrender national control (France) or influence (Germany) over their strategic firms in order to benefit from efficiency gains and achieve critical size in the global competition through transnational consolidation. Whereas the two countries prioritized economic efficiency over national security and autonomy concerns, the UK chose the national champion strategy, waiving the advantages encompassed within this big cross-border merger. Yet, the British government was able to preserve national control over the now even larger BAe without having to compromise and share competences and manufacturing capacities with other countries. Moreover, instead of profiting from efficiency gains through European consolidation, BAe followed a strategy of moving into the US defense market, becoming a major contractor to the US department of Defense (Johnson 2010: 486). Hence, the UK succeeded in gaining from cooperation with the US while also staying an all-British firm. From a political perspective, the UK missed the chance to be part of an important contribution to European defense-industrial integration.

In this thesis I developed a causal pathway of government strategy formation and demonstrated that country-specific politico-economic institutions can explain the variation in the eventual choices of strategy. In my process-tracing analysis, I show that governments' preferences, although playing a certain role, cannot account for this variation (5.2). All three governments of the countries selected in this thesis favored the formation of a single European company. However, as highlighted in my argumentation, the industrial sector investigated here is located at the intersection of a market logic and a political logic. From this it follows that governments cannot simply implement their preferences but need to coordinate with private industrial actors to decide for a strategy.

In the main part of the process-tracing (5.3) I presented empirical evidence for my argument that national institutional settings allow for different coordination mechanisms (Hall & Soskice 2001) and these coordination mechanisms, in turn, induce different outcomes: Strategic interaction is creating opportunities for the alignment of interests and the formation of coalitions that share common goals. Consequently, strategic interaction enables agreements that are based on cooperation and compromise. My process-tracing analysis illustrates that public and private actors within Germany and France engaged in strategic interaction enabled through network structures and, hence, each succeeded in agreeing on a transnational champion strategy, even though this implied less national control for the government. In contrast, arm's length-coordination in the UK meant that Prime Minister Blair refrained from intervening in British Aerospace's business decision to withdraw from the European merger project. His passiveness resulted in the prevailing of private interests, which were opposed to the preferences of the British government.

By tracing the process of government strategy formation, I was able to confirm my hypotheses 1 and 2 about the varying implications of different institutional settings in LMEs versus CMEs and SMEs. I described the impact of non-market coordinating institutions like networks and business associations on governments' choices of strategy. Thus, I could show that strategic interaction as coordination mechanism made a difference and eventually led to a different strategy than the arm's length-coordination did.

As regards the role of the governments, they behaved according to my expectations: First, the UK government stayed out of the decision for a strategy, although it was holding a golden share. Second, the German government acted supportive towards its national champion and facilitated the merger deal by sending representatives to the negotiations to advocate for DASA's demand to reduce the French state's stake. And third, the French government arranged the 'marriage' between Aérospatiale and Matra to gain a private partner which would be helpful in the following negotiations about a European merger. In sum, the British government refrained from intervening in the decision, the German government intervened in a cooperative way and the French government intervened in a more hierarchical way. These results are in line with the theorized behavior according to the Varieties of Capitalism literature (Hall & Soskice 2001; Schmidt 2003; Schmidt 2009).

With regard to Hypothesis 3, I illustrated that strategic interaction is also possible on a transnational level. If there is an institution that enables strategic interaction, for example a network comprised of transnational elites, actors can also coordinate strategically to find an agreement on the transnational level. However, my data basis here is hardly comprehensive and I can only identify the key role played by Jürgen Schrempp and Jean-Luc Lagardère in firstly initiating the merger talks and secondly being decisive actors in convincing the French government to make this big concession and reduce its stake – which in the end was the key to success. Both are powerful European industrialists and certainly well connected through economic elite networks. Yet, more detailed data is needed to confirm that transnational elite networks exist and that they play a role in transnational mergers and acquisitions in general and specifically in this case.

6.2 Contribution to the literature

In my thesis I made several contributions to existing research on the political economy of the aerospace and defense sector, while possibly also contributing to the understanding of the idiosyncrasies of strategic industries in general. First, I demonstrated that explanations focusing on drivers of consolidation as well as explanations based on governments' preferences are only suited to show that there was a demand for consolidation of the European aerospace and defense industry. Here, International Relations approaches relying on realist and functionalist approaches are too state-centric, remaining on the macro-level of analysis and thus neglecting the role private actors play in the process. Second, in my thesis, I went beyond these approaches to capture the exact outcome of the European consolidation effort in the sector and explain why France and Germany were successful in building a European champion while the UK decided not to be part of it. I introduced an argument that includes the effects of institutions on the decision-making about consolidation strategies. Thereby I revived the theoretical framework by Colli et al. (2014) and applied it to the aerospace and defense sector, which was identified as a potential case for further research by the authors. Hence, I closed this gap in the literature and strengthened the confidence in their framework. Third, I developed this theoretical framework further by conceptualizing it as a causal pathway in which national institutional settings induce a certain consolidation strategy, while the coordination mode represents the causal mechanism responsible for the variation. Fourth, by this I also contributed to confirming the claim of the importance of national institutions made by the Varieties of Capitalism approach in a further empirical case study. Fifth, I suggested elevating the coordination mechanism of strategic interaction onto the transnational level to test whether non-market institutions like networks as well have an effect on finding collaborative solutions on this level of interaction. Finally, in order to illustrate that governments face an especially difficult trade-off between two major goals of policy-making (national security and economic efficiency) when making choices about the aerospace and defense sector, I conceptualized the *security–efficiency trade-off*, which well reflects on the specific structure of this sector.

6.3 Limitations and further research

My thesis presents evidence from three in-depth national case studies plus one transnational case study. By conducting a comparative process-tracing analysis, I identified the presence and absence of one particular coordination mechanism (strategic interaction) to result in varying outcomes. Thus, I compared within-case inferences from my case studies in order to make a statement about the effect of my causal mechanism. However, my explanation and thus my causal pathway of government strategy formation is developed closely along the case studies. Consequently, while it yields inference on these exact case studies, generalization beyond my cases is limited and requires further testing. Nevertheless, theory-building process-tracing aims at finding a plausible explanation for one (or a few) cases, which then is supposed to be tested on other cases. This can firstly be done in other cases of (transnational) consolidation or privatization in the same sector and secondly, in other strategic sectors like telecommunications, energy or railway in which government control plays a significant role.

Although my causal pathway of government strategy formation provides a *plausible* explanation for the variation in the outcome, the individual parts of the mechanism (coordination, alignment of interests, coalition-building) are not necessarily *sufficient* to explain the outcome. Other explanations as well as additional parts of the causal mechanism are conceivable. Further research in other strategic sectors would thus be useful to strengthen the confidence in my argument by investigating in more detail the individual parts of the causal mechanism. Moreover, confirming my claim for strategic interaction as coordination mechanism on a transnational level requires further research and in particular evidence for the existence of a transnational network.

In sum, this thesis has brought insights into the role governments play in a strategic industrial sector and how this role changes due to globalization and industry restructuring. I revealed that governments choose a transnational consolidation strategy when they are able to coordinate strategically with their private industrial actors and form a coalition with aligned interests.

When governments rely on an arm's length coordination with their private actors, they lack this alignment of interests and are more likely to choose a national consolidation strategy. In this vein, strategic interaction promotes collaborative solutions due to the reduction of uncertainty over the future behavior of other actors. Consequently, in countries where strategic interaction within networks and through intermediary institutions is institutionalized, governments can more easily accept to surrender national control over strategic firms.

This has implications for the governance of the aerospace and defense sector under the impact of globalization, privatization and Europeanization. We can conclude that governments still play an important role in this regard, albeit to varying degrees across the different countries. Nevertheless, the role of private industrial actors becomes increasingly important and governments rely on cooperative relations with those actors in order to implement their own preferences. In 1999, the willingness of both, industrial and political actors, to build a European champion was matching and European defense-industrial integration advanced one significant step further. However, already a bit more than one decade later in 2012, the French and German governments demonstrated their still existing influence by blocking a tentative mega merger of EADS and BAe Systems, citing concerns about the loss of their national control over the company (Barbaroux & Laperche 2013). Hence, institutions that provide for strategic coordination, trust and commitment between public and private actors are still important in order to allow for further European integration of the aerospace and defense industry as well as any other strategic industries.

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